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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

KAUFMANN AND BAER COMPANY

and

GIMBEL BROTHERS, INC.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

HARRY J. RUDICK
Counsel for Petitioners
25 Broadway
New York 4, New York

ALEXANDER B. ROYCE,
MASON G. KASSEL,
ROBERT E. FRIOU,
Of Counsel.

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioners, Kaufmann and Baer Company, and Gimbel Brothers, Inc., as successor to Kaufmann and Baer Company, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Claims, entered in the above entitled case on January 31, 1956, which dismissed a petition to recover an overpayment of income tax for the fiscal year ended January 31, 1942.

Citation to Opinion Below

The opinion of the Court of Claims, printed in Appendix B hereto, *infra*, p. 27, is as yet unreported.

Jurisdiction

The judgment of the Court of Claims was entered on January 31, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255(1).

Question Presented

Whether the petitioner made a valid election to adopt the last-in, first-out method of determining its inventories (commonly known as LIFO) for the fiscal year ended January 31, 1942 and whether the refusal of the Commissioner of Internal Revenue to give effect to such election was, under the circumstances existing here, arbitrary, discriminatory and in derogation of law.

Statutes and Regulations Involved

The statutes, regulations and rulings involved are Sections 22(c) and (d) of the Internal Revenue Code of 1939, as amended, 26 U. S. C., Section 22; Treasury Regulations 103, Section 19.22(d), and Mimeograph 6244, 1948-1 Cum. Bull. 21. The pertinent provisions are printed in Appendix A, *infra*, p. 20.

Statement of the Case

During the years 1941 and 1942, the petitioner, Kaufmann and Baer Company,[1] was engaged in the business of

[1] Kaufmann and Baer Company was since 1926 a wholly-owned subsidiary of Gimbel Brothers, Inc. In 1946, Kaufmann and Baer Company was liquidated and all of its assets were transferred to its parent.

operating a retail department store in Pittsburgh, Pa. In common with most large department stores, it used the retail method of inventory valuation in computing the cost of goods sold. This method of inventory valuation, which has long been approved by the Treasury Department, states inventories in terms of dollars for each department of the store rather than in terms of the cost of each specific item of goods. Cost is determined by reducing the retail selling price of all the items in a particular department by the mark-on percentage. Since under this method, the acquisition date and cost of the goods in the inventory can not be specifically identified, the procedure was to assume that the first goods sold during the taxable year were those first purchased. This is the first-in, first-out method, commonly known as FIFO, which was uniformly used in the industry until 1942. (Findings 2, 3, 9, 10, 11, Appendix B, *infra*, pp. 37, 40-43.)

In 1940, after the beginning of World War II, American department store executives, including those of petitioner, remembering their experience in the First World War, became concerned about rising prices and the impact of inflation on inventories taken on a FIFO basis. The cost of goods sold is lower during a period of rising prices under the FIFO method, with the result that gross profit on sales is greater than is the case when the cost of goods sold is determined on the assumption that the first goods sold during the taxable year are the last goods purchased by the Company. This is the last-in, first-out method of inventory valuation, commonly known as LIFO. (Tr., pp. 41, 42.)

Section 22(d) of the Internal Revenue Code of 1939[2] providing for the use of LIFO was originally enacted in 1938 but its use was restricted to tanners and producers and processors of certain non-ferrous metals. In 1939, how-

[2] Hereinafter, a reference to the Code will be to the Internal Revenue Code of 1939.

ever, the section was amended so as to make LIFO available to all taxpayers meeting the requirements of the section. Among those requirements were (1) that LIFO inventories must be reported at cost which, in the case of users of the retail method of inventory valuation, necessitated authorization by the Treasury Department of the use of price indices (because that is the only feasible method of arriving at cost) and (2) that the taxpayer must not have made any report (either annual or interim) to stockholders or creditors during the taxable year on any basis other than LIFO.

In December 1939, the Treasury Department promulgated Regulations pursuant to Section 22(d). Those Regulations did not apply to users of the retail method because they permitted the use of LIFO only if it was applied to the cost of *specific* inventory items and they made no provision, by use of a statistical price index, for the adjustment to a LIFO cost basis of inventories taken on the retail method. Under these Regulations, users of the retail method, such as petitioner, were unable to use LIFO because of the impracticability of matching hundreds of thousands of physical units of a heterogeneous retail inventory at the beginning and end of a taxable period. (Findings 12 & 15, Appendix B, *infra*, pp. 43, 47.)

From December 1939, until March 9, 1948, the Commissioner of Internal Revenue and representatives of the Treasury Department took the consistent position that "LIFO was available only to taxpayers who applied the method to the cost of specific inventory items, and that LIFO was not available to taxpayers who applied the method to the total inventory of each department of a department store". (Finding 12, Appendix B, *infra*, p. 43.)

The petitioner's income tax return for the fiscal year ended January 31, 1942 was not filed until July 1942. At that time, petitioner was ineligible to adopt LIFO under

Section 22(d) because it had filed an interim report to stockholders for the first six months of the fiscal year ended January 31, 1942 on the FIFO basis. However, on October 21, 1942, Section 22(d) was amended, retroactive to all taxable years beginning after December 31, 1938, by eliminating therefrom the interim report requirement. As a result of such amendment, a taxpayer (except, under the Treasury Regulations, one using the retail method) could elect to use LIFO regardless of the fact that it may have used some method other than LIFO in interim reports. (Findings 5, 13 & 14, Appendix B, *infra*, pp. 38, 44-46.)

As a result of this amendment, the original LIFO Regulations were amended in *December 1942* so as to give those taxpayers who had theretofore been prohibited from using LIFO because of the interim report requirement the right to elect LIFO for tax purposes by filing Treasury Department Form 970 (Revised) within a period of 90 days which expired on March 10, 1943. However, like the original LIFO Regulations, these amended LIFO Regulations (because of the Treasury's position that LIFO was not available to those using the retail inventory method) did not make any provision for adjustment to the LIFO basis, by use of a statistical price index, of inventories taken on the retail method and hence made no provision for retailers such as the petitioner. (Findings 12 & 16, Appendix B, *infra*, pp. 43, 47, 48.)

After the amendment of the Regulations in December 1942, Gimbel's executives, at a meeting with their independent accountants in that month, instructed the accountants to prepare refund claims and elections on Form 970 (Revised) to adopt LIFO for the fiscal year ended January 31, 1942 in behalf of Gimbels and its subsidiaries. They relied on the accountants, a nationally-known firm, to properly prepare and file such claims. The necessary Form

970 (Revised) was not issued by the Treasury Department until the end of February 1943, approximately ten days prior to the March 10, 1943 deadline.[3] The refund claims and elections on Form 970 (Revised) were sent by the accounting firm to petitioners in New York on March 25, 1943 and they were filed in Pittsburgh on March 31, 1943.[4] (Findings 18 and 19, Appendix B, *infra*, pp. 48, 49.)

In 1942 and subsequent years until 1948, the National Retail Dry Goods Association, of which petitioners were members, was active in challenging the Treasury's position with respect to the adoption of LIFO by retailers. A procedure was worked out by the National Retail Dry Goods Association under which its members, if they were willing to do so, would attempt to adopt LIFO for the fiscal year ended January 31, 1942 and thereafter. Pursuant to such procedure, in the spring and summer of 1942, approximately 75 large department stores filed their returns on a LIFO basis for the fiscal year ended January 31, 1942 and, with said returns, filed elections on Form 970 (the old and not the revised form) to adopt LIFO even though many of these retailers had issued interim reports to stockholders, partners and creditors on a FIFO basis and thus technically were not eligible to adopt LIFO under the statute as it then read.[5] In this group there were several companies such as Federated Department Stores, Allied Department Stores, Hutzler Bros., Bloomingdale Bros. and

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[3] The court below has found that it would have been very difficult for the accounting firm to have prepared and filed the claims and elections within the 10-day period. (Finding 19, Appendix B, *infra*, p. 49).

[4] Form 970 (Revised) was not different in important particulars from the previous Form 970, but this neither the petitioner nor the accountants knew until it was issued about 10 days before the deadline set by the Regulations.

[5] In computing their inventories on LIFO, these stores used price indices prepared in their behalf even though the regulations did not permit such use.

Halle Bros. who had issued interim reports to shareholders, creditors or others on a FIFO basis and thus were not eligible in the spring or summer of 1942 to file LIFO elections or compute their income taxes for the fiscal year ended January 31, 1942 on a LIFO basis. This group cooperated in the case of *Hutzler Brothers Co.* v. *Commissioner,* which was instituted in the United States Tax Court and defrayed part of the costs of the litigation. On January 14, 1947, the Tax Court in the *Hutzler Brothers Co.* case (8 T. C. 14) held that a retailer using the retail method and valuing its inventory by department dollar totals at retail and at cost based upon price indices and not by specific items could use LIFO. In that case, as the Tax Court noted at page 27, the Commissioner raised "no question as to petitioner's compliance with the technical requirements of the section * * * such as * * * use of the system (LIFO) in its financial reports." Subsequent to the decision by the Tax Court in the *Hutzler* case, no elections were filed by these companies on Form 970 (Revised) but nonetheless the Treasury Department recognized their right to use LIFO for the fiscal year ended January 31, 1942 and for all subsequent fiscal years without the necessity of filing new elections. (Finding 26; Tr., pp. 79, 80, 82, 83, 183 to 188, incl., 197, 205, 209.)

Thereafter, in Treasury Decision 5605, 1948-1 C. B. 16 (March 4, 1948), which amended the LIFO Regulations promulgated under Sections 22(c) and (d) of the Code so as for the first time to make them applicable to users of the retail method, the Commissioner stated (p. 17):

> "The amendments are made in order to adapt the retail inventory requirements of the regulations to the elective (LIFO) inventory principle of section 22(d) of the Internal Revenue Code as enunciated by the Tax Court of the United States in Hutzler Bros. Co. (8 T. C., No. 3 (page 14))."

Similarly, in Mim. 6244, 1948-1 C. B. 21 (March 9, 1948), the Commissioner stated (pp. 21-22):

> "1. Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22(d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. *The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under section 29.22(c)-8 of Regulations 111 and Section 19.22(c)-8 of Regulations 103.*" (Italics supplied.)

Subsequent to the decision of the Tax Court in the *Hutzler* case, the Treasury Department issued proposed regulations under which stores, like Hutzler Brothers Company and the other members of the group of the National Retail Dry Goods Association which cooperated with Hutzler Brothers in the litigation before the Tax Court, were permitted to adopt the LIFO inventory method for the fiscal year ended January 31, 1942, and for subsequent years even though the elections filed by these companies for the fiscal year ended January 31, 1942, were invalid when filed and they had filed no new elections. Thereupon, petitioners objected to the proposed regulations because they did not provide relief for petitioners who in good faith had attempted to adopt LIFO but had been dissuaded from such position by virtue of the Treasury's objection. Thereafter the Treasury advised petitioners that the regulations would

be drawn to apply to those retailers who had persisted in the contest of this issue and the retailers who had not so persisted would be covered by separate regulations. About a year later, petitioners were informed by the Treasury Department that the Department did not intend to draft regulations applicable to petitioners who had evidenced an intention to and had taken affirmative steps to adopt LIFO and who were dissuaded from that position by the Treasury Department's announced policy that LIFO was not available to retailers. (Finding 26, Appendix B, *infra*, pp. 52, 53.)

On April 20, 1951, the Deputy Commissioner of Internal Revenue notified the revenue agent in New York that the instant case might be "susceptible of administrative settlement" and asked him "to determine the proper amount of the LIFO inventories and the refunds of tax for all years for which claims have been filed". An examination of petitioner's books and records was thereafter made in 1952. On June 6, 1953, petitioners were informed that their claims would not be allowed because the Form 970 elections had not been filed by March 10, 1943 and that they had also been withdrawn. This was the first time that these technical objections had been raised with petitioners by either the Treasury Department or the Bureau of Internal Revenue. (Findings 27, 29 & 30, Appendix B, *infra*, pp. 53, 54.)

At the date the petitioners commenced this proceeding, all of the tax years subsequent to 1942 of Gimbels and its subsidiaries including Kaufmann and Baer were open by waiver or otherwise and the Commissioner of Internal Revenue, if the price spiral had turned in the other direction, could have proposed deficiencies for each of the years subsequent to 1942 on the claim that petitioner's LIFO election was valid and that no permission had ever been granted to petitioner to withdraw the election to adopt LIFO.

On October 16, 1945, the Commissioner notified the petitioner that its claim for refund had been disallowed and on August 11, 1947, within two years from the date of the disallowance of the claim for refund, the suit below was commenced. Jurisdiction of the Court of Claims was invoked under Section 3772 (a) of the Internal Revenue Code of 1939, 26 U. S. C., Section 3772 (a). The Court of Claims dismissed the petition solely upon the ground that petitioner's election to adopt LIFO was not filed until 21 days after the expiration of the 90-day period set by the regulations for such filing.

Reasons for Granting the Writ

I. This case presents important questions relating to the equitable administration of the tax laws which should be decided by this Court.

II. The decision below is in direct conflict with the principles laid down by the Court of Appeals for the District of Columbia in *The Pictorial Review Company* v. *Helvering*, 68 F. 2d 766 (D. C. Cir. 1934); and *A. Stockstrom, Exr.* v. *Commissioner*, 190 F. (2d) 283 (D. C. Cir. 1951).

I.

This case presents important questions relating to the equitable administration of the tax laws which should be decided by this Court.

A. Where a regulation is inapplicable to a taxpayer, a time limitation contained therein cannot be binding on the taxpayer.

The court below denied petitioner's claim for refund on the ground that the claim was filed on March 31, 1943, 21 days after the 90-day time limitation prescribed by T. D. 5199, amending Treasury Regulations 103, Section 19.22(d).

The Commissioner, however, has admitted that at the time T. D. 5199 was issued and for many years thereafter, the settled policy of his office and the Treasury Department was that this regulation did not apply to taxpayers such as petitioner who used the retail inventory method of valuation. In Mimeograph 6244, explaining the changes made in the regulations after they were amended in 1948 to allow users of the retail inventory method to use LIFO, the Commissioner stated:

> "The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. *The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method.* . . . Treasury Decision 5605, approved March 4, 1948 [page 6, this Bulletin], amends Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers using the retail inventory method." (Italics supplied.)

Moreover, since the use of price indices to establish the cost at the beginning of the year, of the inventory on hand at the close of the year, is essential in adapting LIFO to the retail inventory method, the failure of the LIFO regulations prior to 1948 to provide for the use of price indices further shows that those regulations had no application to users of the retail inventory method. Finally, it is clear from the record that from 1939 to 1948 the Treasury Department and the Bureau of Internal Revenue were adamant in their insistence that the LIFO regulations were not applicable to users of the retail inventory method.

Since the regulations did not apply to petitioners, the time limitation therein could not apply to them. *The Pictorial Review Company* v. *Helvering*, 68 F. 2d 766 (D. C.

Cir. 1934). Nevertheless, the petitioners clearly had a statutory right to elect the LIFO inventory method (*Hutzler Brothers Co.*, 8 T. C. 14 (1947)) and in the absence of a time limitation applicable to them for filing such election, they had the right to file within a reasonable time. *The Pictorial Review Company* v. *Helvering, supra; J. W. and A. P. Howard Co.*, 15 B. T. A. 1096 (1929); *F. Harold Johnston, Exr.*, 33 B. T. A. 551 (1935); *Morrow, Becker and Ewing, Inc.* v. *Commissioner*, 57 F. (2d) 1 (5th Cir., 1932). The reasonableness of the time within which petitioner filed its election has never been questioned. The petitioner, on March 31, 1943, did not have the benefit of hindsight and its filing at that time in no way jeopardized the government's interest. Cf. *Haggar Co.* v. *Helvering*, 308 U. S. 389 (1940).

The propriety of binding a taxpayer by a time limitation contained in a regulation which the Treasury Department specifically maintained to be inapplicable to the taxpayer raises a question of general and widespread importance which this court should decide. Moreover, the particular issue involved in this case involves numerous other retailers, who like the petitioner did not file their LIFO elections within the time prescribed by the regulations which, as pointed out, were inapplicable to users of the retail inventory method. Resolution of this issue by this Court will therefore preclude a multiplicity of suits on this point.[6]

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[6] The regulations in 1942 gave users of the retail method no right of election since they did not provide the means for implementing the statute. "The doctrine of election implies that a taxpayer is given the option of freely taking two courses of action; where there is no freedom of choice and the election is by compulsion, the rule is inapplicable." *Mertens, Law of Federal Income Taxation*, (1948 ed.) Volume 10A, Sec. 60.17. In 1942, users of the retail method were given a "Hobson's choice", i.e., a choice without an alternative.

B. **The Commissioner may not arbitrarily discriminate in the administration of the tax laws by waiving technical defects in elections filed by a large number of petitioner's competitors while at the same time refusing to waive a technical defect, if indeed there was one, in the election filed by petitioner.**

The opinion below does not advert to the fact (although it is set forth in Finding 26) that after the Tax Court decision in *Hutzler Brothers Co.*, 8 T. C. 14 (1947), "the Treasury Department issued proposed regulations under which stores, like Hutzler Brothers Company and the other members of the group of the National Retail Dry Goods Association which cooperated with Hutzler Brothers in the litigation before the Tax Court were permitted to adopt the LIFO inventory method for the fiscal year ended January 31, 1942, and for subsequent years even though the elections filed by these companies for the fiscal year ended January 31, 1942, were invalid and they had filed no new elections". The elections referred to were invalid because at the time of their filing, the statute provided that a LIFO election could not be made if interim reports on a non-LIFO basis had been issued during the year the LIFO method was to be adopted, and the taxpayers referred to had issued such interim reports. When the Commissioner in 1948 allowed such taxpayers, who had never subsequently filed valid elections within the time period prescribed by T. D. 5199, to nevertheless use LIFO, he should have been precluded from refusing to recognize the election filed by petitioner.

There is no reasonable basis to justify the Commissioner's waiver of technical defects in the elections filed by petitioner's competitors, and his refusal to waive the technical defect, if indeed there was one, in the petitioner's election. This is especially true since the elections filed by petitioner's competitors were in violation of the *statute*, whereas petitioner did comply with the statutory require-

ments and merely did not comply with the time limitation prescribed by the Commissioner's *regulations* (which, however, the Commissioner held were not applicable to it).

As has been noted, the petitioner's filing of the election on March 31, 1943 in no way affected or jeopardized the interests of the government. This election was irrevocably made within a reasonable period of time after the statute was amended on October 21, 1942 to accord petitioner the right to elect the LIFO inventory method, and long before any hindsight could be applied to see if changes in the price spiral would make such an election disadvantageous. Cf. *Haggar Co.* v. *Helvering*, 308 U. S. 389 (1940).[7]

It should also be noted that although petitioner's election was filed on March 31, 1943, the technical defect alleged (late filing) was not asserted by the Commissioner until June 1953, more than 10 years later and after the Commissioner had reexamined the petitioner's returns with a view to allowing the claims. To allow the Commissioner to refuse to recognize the petitioner's election because it was filed 21 days after the March 10th deadline, prescribed in regulations not applicable to taxpayers using the retail inventory method, and in the face of his waiver of the defective elections filed by many of the petitioner's competitors, would sanction the Commissioner's right to discriminate as against competing taxpayers in the enforcement of the tax laws. Such a power would be so inimical to the concept of equal protection of the laws, that its sanction should alone be sufficient ground for this Court to review the dismissal of the petitioner's suit by the Court of Claims.

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[7] Cf. *Louis Pizitz Co., Inc.* v. *Deal, et al., Exrs.*, 208 F. 2d 724 (5th Cir., 1953) in which an election to report a portion of inventory under the involuntary liquidation provisions of section 22(d)(6) was filed five years after the date on which the return was due for the earliest taxable year. The election was held to be untimely because made at a time when the taxpayer had the benefit of hindsight and could determine whether or not the election would be advantageous.

C. The doctrine of equitable estoppel should apply to the Commissioner's action in so administering the tax laws.

From 1939 to 1948 the Commissioner insisted that users of the retail inventory method could not adopt LIFO, and refused to promulgate regulations applicable to such taxpayers. Consequently, petitioners and other users of the retail method did not comply with the time limitation contained in such inapplicable regulations.

The courts have held that the Commissioner is bound by a rule of consistency in his dealings with a taxpayer; *Joseph Eichelberger and Co.* v. *Commmissioner,* 88 F. (2d) 874 (5th Cir. 1937); *Staten Island Hygeia Ice and Cold Storage Co.* v. *U. S.,* 85 F. (2d) 68 (2nd Cir. 1936); *U. S.* v. *Brown,* 86 F. (2d) 798 (6th Cir. 1936); *Canada Dry Bottling Co. of Florida* v. *Fahs,* 109 F. Supp. 187 (S. D. Fla. 1952); and that a person "who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned". *United States* v. *Peck,* 102 U. S. 64 (1880); *Stearns Company* v. *U. S.,* 291 U. S. 54, 61 (1934); *A. Stockstrom, Exr.* v. *Commissioner,* 190 F. (2d) 283 (D. C. Cir. 1951).

Not only did the Commissioner himself induce the technical non-compliance with the March 10th deadline in the regulations, but his subsequent actions over a ten year period also provided adequate grounds for an estoppel. It is clear that the Commissioner could have held petitioner to its LIFO election had the price spiral gone down. In such case, the petitioners would hardly have been able to avoid the consequences of their irrevocable election by claiming their own technical non-compliance with the regulation. *Burnside Veneer Co.* v. *Commissioner,* 167 F. (2d) 214 (6th Cir., 1948); *Service Co.* v. *Commissioner,* 165 F. (2d) 75 (8th Cir., 1948); *Alabama Pipe Co.,* 23 T. C. 95 (1954). The Commissioner thus kept himself in a position where he

could move either way, thus taking advantage of hindsight, and, if prices declined, could have held petitioner to its LIFO election. By knowingly compelling petitioner for many years to be exposed to the risk of a downward turn in the price level, the Commissioner should clearly have been estopped from denying the validity and irrevocability of petitioner's election.

The facts in this case clearly justify the application of the doctrine of equitable estoppel and this court should grant review in order to make it clear that the doctrine is applicable to the Commissioner's actions in administering the tax laws.

D. The effect of time limitations for making elections cannot be nullified by requiring the election to be made on forms calling for complex calculations, which are issued just shortly prior to the expiration of the prescribed period of time.

Even if the 90-day period were applicable to the petitioner, the instant case brings into question the reasonableness of providing for an election to be filed on a certain form within 90 days and holding taxpayers to the 90-day limitation when the form on which to make the election first became available approximately 10 days prior to the expiration date of the 90-day period.[8] If the decision below is sustained, the Commissioner would be able, with impunity, to nullify a reasonable time period for making an election, requiring complicated calculations and involved considerations, by withholding the forms on which the elections are to be made until shortly before the expiration of

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[8] The Court below erred in stating in the opinion that other taxpayers using the retail inventory method prepared and filed LIFO elections within the 90-day period. As far as petitioner has been able to ascertain, no user of the retail method filed a LIFO election within the 90-day period.

the period.[9] This, too, raises considerations relating to the equitable administration of the tax laws of far-reaching import, and consequently warrants this Court's review of the decision of the Court of Claims.

II.

The decision below is in direct conflict with the principles laid down by the Court of Appeals for the District of Columbia in The Pictorial Review Company v. Helvering, 68 F. 2d 766 (D. C. Cir. 1934); and A. Stockstrom, Exr. v. Commissioner, 190 F. (2d) 283 (D. C. Cir. 1951).

A. Conflict with The Pictorial Review Company v. Helvering.

The decision below cannot be reconciled with the decision in *The Pictorial Review Company* v. *Helvering,* 68 F. (2d) 766 (D. C. Cir. 1934).

In *The Pictorial Review Company* v. *Helvering, supra,* the statute and regulations provided that members of an affiliated group might elect to file separate or consolidated returns and if a return were made on either basis, all subsequent returns were required to be made on the same basis.

The taxpayer filed a consolidated return excluding one related corporation which filed a separate return because under the regulations applicable when the returns were filed, that corporation was not part of the affiliated group. Some years later the regulations were changed so that the excluded corporation was treated as part of the affiliated group. The court upheld the taxpayer's right to amend its earlier consolidated return to include that corporation.

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[9] The Court below suggested that petitioner could have applied for an extension of time to file the election, but that suggestion overlooked the fact that in 1943, the Regulations did not provide any authority for an extension of time with respect to an election. The Regulations were subsequently amended in 1944 to give such authority. See T.D. 5391, 1944 Cum. Bull., p. 474.

In its view the taxpayer's right to elect whether or not to file on a consolidated basis with that corporation did not exist so long as the regulations did not treat such corporation as part of the affiliated group. Under the principle of this decision also, the provisions respecting elections contained in a regulation cannot be binding on taxpayers not covered by the regulation. See also *W. K. Buckley, Inc.*, v. *Commissioner*, 158 F. 2d 158 (2nd Cir. 1946).

B. Conflict with A. Stockstrom, Exr. v. Commissioner.

The decision below is in direct conflict with the decision of the Court of Appeals in *A. Stockstrom, Exr.* v. *Commissioner*, 190 F. (2d) 283 (D. C. Cir. 1951).

In that case, the court held that the Commissioner's action in ruling that a donor was not required to file a gift tax return barred him from asserting gift tax liability against the donor's executor despite the statutory provision that in the event of a failure to file a return, the tax could be assessed at any time. The ground of the decision was that the Commissioner could not take advantage of the donor's failure to file a return when that failure had been caused by his own action.

In the court below, the Government was allowed to rely on the technical defense of non-compliance with regulations which the Government steadfastly insisted were not applicable to the petitioner. This directly conflicts with the holding in *Stockstrom* that "one may not found a claim upon an omission which he himself has induced".

Conclusion

For the reasons stated above, petitioners pray that a Writ of Certiorari issue to the United States Court of Claims to review its judgment.

Respectfully submitted,

HARRY J. RUDICK
Counsel for Petitioners

Of Counsel
ALEXANDER B. ROYCE,
MASON G. KASSEL,
ROBERT E. FRIOU.

Dated: April, 1956

Appendix A

Statutes and Regulations Involved

INTERNAL REVENUE CODE OF 1939:

Sec. 22. Gross Income. * * *

(c) *Inventories:*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) Method Used In Inventorying Goods.—(As amended by Sec. 219 (a) of the Revenue Act of 1939 and Sec. 118 of the Revenue Act of 1942.)

(1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: first, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

(5) If a taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) The Commissioner determines that the taxpayer has used for any such subsequent taxable year some procedure other than that specified in subparagraph (B) of

paragraph (1) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries or (ii) for credit purposes; and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(26 U. S. C., Sec. 22.)

TREASURY REGULATIONS 103, PROMULGATED UNDER THE INTERNAL REVENUE CODE OF 1939:

Sec. 19.22 (d)-2 (As amended by T. D. 5163, July 14, 1942, and T. D. 5199, Dec. 10, 1942). Requirements incident to adoption and use of elective method.—The adoption and use of the elective inventory method is, by section 22 (d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant

to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year with the exception that restoration shall be made with respect to any write-down to market values resulting from the pricing of former inventories;

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22(d) as having been acquired all at the same time; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer; • • •

• • • • •

Sec. 19.22 (d)-3 (As amended by T. D. 5199, Dec. 10, 1942 and T. D. 5207, Jan. 1, 1943). Time and manner of

making elections.—The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised) and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. * * *

* * * * *

Sec. 19.22 (d)-5. *Revocation of election.* —An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him as provided in section 19.41-2.

* * * * *

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Section 29.22(d)-2: Requirements incident to adoption and use of elective method.

Use of elective inventory method by taxpayers using retail inventory method.

TREASURY DEPARTMENT
OFFICE OF COMMISSIONER OF INTERNAL REVENUE
Washington 25, D. C., March 9, 1948.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

1. Section 22 (d) (1) of the Internal Revenue Code provides an elective method for inventorying goods, commonly referred to as the last-in, first-out, or LIFO, inventory method. Section 22 (d) (2) (A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under section 29.22 (c)-8 of Regulations 111 and section 19.22 (c)-8 of Regulations 103.

2. The Tax Court held in the case of *Hutzler Bros. Co.* v. *Commissioner* (8 T. C., 14) that a taxpayer using the retail inventory method is entitled to use the elective inventory method. The grouping of goods by classes under the retail inventory method necessarily involves the use of some type of index numbers for measuring the extent of price changes in the various classes of goods concerned. The decision laid down no rule concerning the nature or type of index numbers which might be proper, nor did it prescribe other details of methods for applying the LIFO method in the case of retail merchants.

3. Treasury Decision 5605, approved March 4, 1948 [page 16, this Bulletin], amends Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers using the retail inventory method. Certain

principles are laid down for the application of the elective inventory by such taxpayers. First, since the elective method requires the use of cost, the retail selling prices of goods included in the opening inventory and purchased during the year must be adjusted for mark-downs as well as mark-ups during the year without regard to the taxpayer's previous practice with respect to mark-downs under the retail method. This requirement does not apply to retailers employing the retail inventory method without the use of the elective method. Second, the price indices employed in the adjustment of the apparent cost of goods in the closing inventory for price changes taking place during the year must be shown, to the satisfaction of the Commissioner, to be acceptable. Any price indices must be based upon sound statistical principles of construction and upon adequate records to be kept available for examination by the Bureau.

4. Arrangements have been made between representatives of the retail trade and the United States Bureau of Labor Statistics for that agency to compute and publish a series of group index numbers of retail prices, on a country-wide basis, suitable for use by individual department stores, which will be acceptable to the Commissioner. These index numbers will cover the period from 1941 to the present on a semiannual basis, and will appear semiannually in the future. The use of such indices of the Bureau of Labor Statistics is not mandatory; indices may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indices, not only for the particular year in question, but for subsequent years. Retailers who have filed, on the basis of the elective method, returns for past years which are still open, and who used indices that are not acceptable to the Commissioner, may file amended returns employing indices.

* * * * *

Appendix B

IN THE UNITED STATES COURT OF CLAIMS

No. 47844

(Decided January 31, 1956)

KAUFMANN AND BAER COMPANY AND GIMBEL BROTHERS, INC. v. THE UNITED STATES

Mr. Harry J. Rudick for the plaintiffs. *Messrs. Alexander B. Royce, Mason G. Kassel* and *Robert E. Friou,* were on the briefs.

Mr. John A. Rees, with whom was *Mr. Assistant Attorney General H. Brian Holland,* for the defendant.

Mr. Andrew D. Sharpe was on the brief.

LITTLETON, *Judge,* delivered the opinion of the court:

The plaintiffs,[1] Kaufmann and Baer Company and Gimbel Brothers, Inc., sue to recover an alleged overpayment of taxes for the fiscal year ending January 31, 1942. The question presented is whether Kaufmann and Baer Co. is entitled to have its taxable income for the fiscal year ended January 31, 1942, computed by valuing its opening and closing inventories for that year on the last-in first-out basis (hereinafter referred to as LIFO) provided in § 22 (d) of the Internal Revenue Code of 1939, as amended, 26 U. S. C. § 22 (d).[2]

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[1] Gimbel Brothers, Inc. owned all of the outstanding stock of Kaufmann and Baer Company. On January 31, 1946, Kaufmann and Baer Company was liquidated and its assets were transferred to Gimbel Brothers, Inc.

[2] Section 22: (d) *Method of inventorying goods.*

(1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

For purposes of this decision the facts may be summarized as follows:

Kaufmann and Baer Company (hereinafter referred to as plaintiff) kept its books and filed its Federal tax returns on the accrual method of accounting. The plaintiff's tax returns for the fiscal year ended January 31, 1942, (the only year in question), and for the succeeding fiscal years to and including the fiscal year ended January 31, 1948, were filed on the retail method of inventory based on the first-in first-out method of valuation (hereinafter referred to as FIFO). Plaintiff's tax returns for the fiscal year ending January 31, 1942, were filed on July 13, 1942, and the taxes shown to be due thereon were paid.

Until October 21, 1942, the date of the approval of the Revenue Act of 1942, 56 Stat. 798, section 22 (d) (2) (B) and Treasury Regulations 101, as amended by T. D. 4959 (1940-1

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) [As amended by Sec. 118(a) of the Revenue Act of 1942, 56 Stat. 798] Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

C. B. 22), approved December 28, 1939, limited the use of LIFO to taxpayers who had used no other procedure other than LIFO in inventorying goods for any period during the first taxable year for which the LIFO method was to be used in reporting to shareholders or for credit purposes. The plaintiff and Gimbel Brothers were ineligible to use LIFO at the time they filed their returns for the fiscal year ending January 31, 1942, because Gimbel Brothers had issued an interim report to its stockholders for the period February 1, 1941 to July 31, 1941, which was prepared on the basis of FIFO.

On April 9, 1942, the directors of Gimbel Brothers decided that at that time it would be in the best interests of the company and its subsidiaries to adopt the LIFO method and they then approved the annual report prepared on the LIFO basis for release to the stockholders. An interim report for the fiscal year ending January 31, 1943, was also issued on the LIFO basis.

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(5) If a taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) [As amended by Sec. 118 (b) of the Revenue Act of 1942, *supra*] The Commissioner determines that the taxpayer has used for any such subsequent taxable year some procedure other than that specified in subparagraph (B) of paragraph (1) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries, or (ii) for credit purposes; and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

* * * * *

Section 118 of the Revenue Act of 1942 removed the prohibition against the adoption of LIFO for a year during which interim reports on a non-LIFO basis had been issued. This change was retroactive to taxable years beginning after December 31, 1938. It did require that annual reports be made on a LIFO basis. The Revenue Act of 1942 was approved on October 21, 1942. Treasury Regulations 103, applicable at that time, were amended to conform to §§ 118 and 119 of that act in T. D. 5199, 1942-2 C. B. 81, approved December 10, 1942, and was published in the Federal Register on December 12, 1942, pp. 10366-10368. As amended by 2 T. D. 5199, § 19.22 (d)-3 of Treasury Regulations 103 read in part as follows:

> *Time and Manner of Making Election.*—The elective inventory method [LIFO] may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. • • •

At a meeting of Gimbel's executives and its accounting firm, held in the latter part of December 1942, it was decided at that time that Gimbel and its subsidiaries should file refund claims for the fiscal year ended January 31, 1942, and elections on Form 970 to adopt LIFO for the fiscal year ended January 31, 1942. The accounting firm was instructed to prepare the refund claims and election forms. Form 970 (revised) became available around the end of February 1943. The expiration date for the filing of this election under the above regulation was March 10, 1943. Application for the change could have been made in time

by the accounting firm but it did not finish the preparation of this form by that date. After preparation of the form it was submitted to plaintiff, and plaintiff filed a claim for refund and the election on Form 970 (revised) on March 31, 1943.

During this period and until the Tax Court decided the case of *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14, on January 14, 1947, the Commissioner of Internal Revenue had taken the position that LIFO was available only to taxpayers who applied the method to the cost of specific inventory items, and that LIFO was not available to taxpayers who applied the method to the total inventory of each department of a department store. The plaintiff employed the latter method, stating its inventories in dollar values rather than in cost of specific items.

The board of directors of Gimbel Brothers decided at a meeting held on April 20, 1943, to issue the annual report on the FIFO basis for fiscal year ended January 31, 1943. The decision to abandon LIFO and revert to FIFO was based on the position of the Commissioner that retailers such as plaintiff might not adopt LIFO, and the disadvantages of keeping books on LIFO and filing tax returns on FIFO. Plaintiff, of course, did not elect to contest the position which the Commissioner had taken. It was also decided at that meeting that Gimbel and its subsidiaries would request permission to withdraw their elections to adopt and use LIFO for its inventory for the fiscal year ended January 31, 1942, and their claims for refund, predicated on the election which had been filed late. The annual report to the stockholders notifying them of the decision to abandon LIFO was issued on April 24, 1943. On April 28, 1943, plaintiff wrote to the collector, referred to their claim for refund and election, and stated:

> This is to advise you that we desire to withdraw this claim for refund and our application for change in inventory method.

The collector informed plaintiff that the claim for refund and election had been sent to the Commissioner in Washington and that plaintiff should advise that office of its intention. The plaintiff wrote the Commissioner on May 5, 1943, referred to the refund claim and election and stated in part:

> Accordingly, we wish to advise you that we desire to withdraw this claim for refund and also to withdraw, or cancel, our application for a change in our inventory method.

The deputy commissioner replied on May 27, 1943, stating that the case had been forwarded to the Agent in Charge in Pittsburgh and that "you will be further advised by that official relative to the matter." This agent made an investigation and found an overpayment separate and apart from the inventory question. He made no change in the inventory method used. He advised plaintiff to file another refund claim for this amount. The plaintiff filed another refund claim on March 23, 1945, and that overpayment was refunded or credited to plaintiff. On August 16, 1945, the deputy commissioner wrote plaintiff, referred to its refund claim for $106,287.97, which was its refund claim based on a change to LIFO, and stated that "this notice of disallowance of your claim or claims to the extent not previously allowed, is hereby given by registered mail." This was simply a pro forma reference, and the claim was not really considered in fact. The plaintiffs filed their petition in this court on August 11, 1947, within two years after August 16, 1945.

The Tax Court held in the *Hutzler Brothers* case, *supra*, January 14, 1947, that a retailer using the retail method and valuing its inventory by department dollar totals at retail and at cost based upon price indices and not by specific items could use LIFO. The Commissioner changed his regulations accordingly and settled certain cases on that basis. The deputy commissioner notified the revenue agent in New

York that the case at bar might be susceptible of administrative settlement and asked him to look into the matter. However, on June 6, 1953, plaintiff was notified that its claim could not be allowed because of its failure to file a timely election and further because its election had been expressly withdrawn. The plaintiff brought this action on the basis that its election to use LIFO was made within a reasonable time and that the attempted withdrawal of the election was ineffective since such election was irrevocable.

The defendant contends at the outset that this court lacks jurisdiction in this case because plaintiff not only withdrew its election but also withdrew its claim for refund. In answer to this plaintiff claims that the attempted withdrawal of its claim for refund was conditioned on the Commissioner's allowance of the withdrawal or cancellation of its application to change its inventory method to LIFO, and that the Commissioner did not write it approving its withdrawal. Although plaintiff's letters of attempted withdrawal do not specifically condition the withdrawal of the claim for refund on the Commissioner's allowance of the withdrawal of its application to change to LIFO, it is obvious that plaintiff intended to withdraw both its election and claim for refund and this was so understood by the Commissioner.

If the plaintiff could get over the hurdle of not having filed a timely election to change to LIFO, the question on the merits would be whether the filing of plaintiff's election to change to LIFO was irrevocable and therefore could not be changed without the Commissioner's written consent.

We find, however, that plaintiff failed to file a timely election to change to LIFO for the fiscal year ended January 31, 1942. The plaintiff had 90 days within which to file an election under the regulations as amended by T. D. 5199, which are hereinbefore set out. The plaintiff contends that it did not believe that the 90-day period applied to it

because of the Commissioner's position that retailers who inventoried their goods on dollar values were not entitled to use LIFO.

The Commissioner was authorized by § 22 (d) to promulgate regulations regarding the application to adopt LIFO and the time and manner in which the application was to be filed. The Commissioner issued the regulations setting forth the time and manner for the filing of the application. Plaintiff had a reputable accounting firm advising it. When the statute and valid regulations give a taxpayer a right it must protect and prosecute that right within the required period, or such extension thereof as may be secured, or the right is lost. Time limitations within which to make elections would be meaningless if the law were otherwise.

The plaintiff also contends that if the 90-day period were applicable to it then the regulation was invalid because it failed to allow a reasonable time within which to file the election. In support of this argument it says that the forms upon which it was to make the election were not made available until the latter part of February 1943, when the expiration date for filing was March 10, 1943, and that it was unreasonable to require the complex computation which was necessary to be done in that short a period. Other taxpayers did it. The plaintiff became entitled to adopt the LIFO method when the 1942 Revenue Act of October 21, 1942, eliminated the interim report prohibition. This was three months before the end of the taxable year in question. The plaintiff's executives first decided in the latter part of December 1942 to adopt LIFO. If the 90 days were insufficient for plaintiff, it could and should have requested an extension of time, which is, in most cases at least, willingly granted. Many of the retailers protected themselves as did the Hutzler Brothers.

We are unable and unwilling to find under the facts and circumstances that are in the record in this case that the 90-day period was insufficient and that it was an unreason-

able period within which to file an election to change to LIFO. Had plaintiff been aware of its rights and acted with diligence it could easily have filed its election within the 90-day period.

The plaintiff contends that the Commissioner has, by his actions over a 10-year period, waived any technical defects in plaintiff's LIFO election and further that the Commissioner is estopped from denying that plaintiff's election was not valid. It is true that the Commissioner did not specifically object to the timeliness of the election until in June 1953. However, objection was unnecessary since plaintiff had stated it did not desire to pursue it. The fact that many cases were settled by the Commissioner even though there were technical defects in the applications to adopt LIFO does not help plaintiff. The plaintiff relies on *United States* v. *Kales*, 314 U. S. 186, 197, in support of its proposition that the Commissioner's action waived the technical requirements with respect to the election. That case involved a refund claim and the Court held that a timely filed informal claim for refund, which was subsequently remedied with a formal claim, sufficed to stop the running of the statute of limitations and although it may have been deficient in specificity, it was sufficient to advise the Commissioner of the nature of the claim. The Court further stated that the lack of specificity was waived by the Commissioner's consistent treatment of the claim as a sufficient claim for refund. The *Kales* case lends little support to plaintiff because in that case the informal claim was timely and matters of particularity or specificity were considered waived. Had the plaintiff here filed a timely election which lacked formal or technical requirements and had pressed it, that rule might be applicable.

Moreover, we do not believe that the Commissioner's action with respect to plaintiff's claim for refund and the LIFO election amounted to a waiver or acceptance of anything. The Commissioner's interpretation of the applicable

sections to mean that retailers using dollar totals rather than specific items could not use the LIFO method was erroneous. If the plaintiff wanted to use the LIFO method it should have filed its returns on that basis and have made a timely election to use the method, as did other taxpayers. The Commissioner's failure to act on the election to use LIFO did not prejudice plaintiff. It could have sought action by the Commissioner or from the courts if it desired. Instead of pursuing its legal remedies plaintiff sought to withdraw its claim for refund and its election. Notwithstanding the fact that plaintiff now contends that it was bound by its election to use LIFO, it consistently filed its tax returns on the FIFO basis and reverted to the FIFO basis in its reports to its stockholders. The record is devoid of any evidence to show that the Commissioner did anything to prejudice plaintiff's rights other than to erroneously interpret § 22 (d).

Although the Commissioner's action in some cases has amounted to a waiver or estoppel we do not believe a consideration of all the facts and circumstances of this case warrants holding that the Commissioner has waived or is estopped from asserting the defense of the untimely filing of plaintiff's election to change to LIFO. Accordingly, we hold that plaintiff's election to adopt the LIFO method was ineffective because it was not timely filed. The petition of plaintiffs is therefore dismissed.

It is so ordered.

LARAMORE, *Judge;* MADDEN, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge,* concur.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and argument of counsel, and the report of Commissioner George H. Foster, makes the following findings of fact:

1. Plaintiff, Kaufmann and Baer Company (hereinafter sometimes called Kaufmann and Baer), was incorporated

under the laws of Pennsylvania in 1913 and since its organization and until January 31, 1946, conducted business in the city of Pittsburgh, Commonwealth of Pennsylvania, where it owned and operated a retail department store.

2. Plaintiff, Gimbel Brothers, Inc. (hereinafter sometimes called Gimbels), is a corporation organized and existing under the laws of the State of New York and it maintains its principal office and a place of business in the city of New York. It is engaged in the business of operating department stores in New York City and elsewhere.

3. Since March 15, 1926, Gimbels has owned all the issued and outstanding capital stock of Kaufmann and Baer. On January 22, 1946, it was duly resolved by the directors of Gimbels to transfer the assets of Kaufmann and Baer to Gimbels, subject to the assumption and payment by Gimbels of all unpaid debts and obligations of Kaufmann and Baer. A similar resolution was duly adopted by the directors of Kaufmann and Baer on January 23, 1946. The liquidation and dissolution of Kaufmann and Baer had been recommended by unanimous resolutions of its shareholders at a meeting held January 23, 1946. Pursuant to such resolutions, Kaufmann and Baer Company on January 31, 1946, filed with the Department of State of the Commonwealth of Pennsylvania a certificate of election to dissolve, in compliance with section 1103 of the Business Corporation Law of the Commonwealth of Pennsylvania, and Kaufmann and Baer continued and still is in existence for the purpose of winding up and settling its affairs, to sue or be sued in its own name, to collect all sums due or owing to the corporation, to sell and convert into cash any assets, to pay, satisfy, and discharge all debts and liabilities, and distribute any surplus remaining to the shareholders in compliance with section 1104 of the Business Corporation Law of the Commonwealth of Pennsylvania. On January 31, 1946, Kaufmann and Baer assigned and transferred to Gimbels all of its property and assets of every kind and nature whatsoever

including choses in action owned by Kaufmann and Baer at the close of the business day on January 31, 1946.

4. Kaufmann and Baer kept its books and filed its Federal tax returns on the accrual method of accounting for the fiscal years ending January 31. In computing the cost of goods sold, it used the retail method of taking inventory.

5. For the fiscal year ended January 31, 1942, the Kaufmann and Baer Company filed its income and declared value excess profits tax return on July 13, 1942. It paid the taxes shown to be due thereon in the amount of $433,111.47 to the collector of internal revenue for the 23rd collection district of Pennsylvania as follows:

Date	*Payment*
April 14, 1942	$100,320.00
July 13, 1942	116,235.73
October 13, 1942	108,277.87
January 12, 1943	108,277.87

The income and excess profits tax paid by Kaufmann and Baer, as shown above, was computed upon the retail method of inventorying goods without application of LIFO thereto.

The Federal income tax returns filed by Kaufmann and Baer and the consolidated returns filed by Gimbels on behalf of Kaufmann and Baer for the fiscal year ended January 31, 1942, and for the succeeding fiscal years to and including the fiscal year ended January 31, 1948, were filed on the retail method of inventory without the applicaton of LIFO. The consolidated return filed by Gimbel Brothers, Inc., for the fiscal year ended January 31, 1948, was filed on the retail method of inventory with the application of LIFO.

6. On March 31, 1943, Kaufmann and Baer filed with the collector of internal revenue, Pittsburgh, Pennsylvania, a claim for refund executed March 29, 1943, a copy of which is attached to the petition as exhibit 1 and is made a part hereof by reference. On the same date, Kaufmann and

Baer also filed with the same collector a document (Form 970) entitled "application for the adoption and use of the elective inventory method," provided by section 22 (d) of the Internal Revenue Code, which has been executed by Kaufmann and Baer on March 29, 1943. A copy of this document is attached to the petition as exhibit 2 and is made a part hereof by reference.

7. An examination made prior to November 21, 1944, by internal revenue agents resulted in adjustments other than in inventories which reduced the tax liability of Kaufmann and Baer for the fiscal year ended January 31, 1942, and produced a net overassessment in income tax of $31,486.16. This amount of the proposed overassessment was accepted by Kaufmann and Baer on December 8, 1944. A copy of the revenue agent's report was transmitted to Kaufmann and Baer by letter of January 4, 1945. Thereafter, in response to a letter from the Deputy Commissioner dated March 12, 1945, Kaufmann and Baer filed a formal claim for the refund of the proposed overassessment on March 23, 1945. This claim was given number 2738120 by the Bureau of Internal Revenue. The overassessment was allowed on Schedule IT—99148 and a refund of that amount was made, part by credit and part by Treasury check, in the amount of $31,486.16, with interest thereon in the amount of $4,587.36. Schedule IT—99148 allowing the overassessment shows that the overassessment of $31,486.16 was an allowance of the claim for refund filed March 23, 1945, and was not the result of the claim field March 31, 1943, which was based on a claim for inventory adjustments.

8. On August 16, 1945, the Deputy Commissioner wrote to Kaufmann and Baer with reference to the claim for refund for $106,287.97 which had been filed March 31, 1943, with Form 970 and stated as follows:

> Reference is made to claim or claims, referred to above, filed by you for the refund of income taxes.

> By a Certificate of Overassessment you were advised of an allowance on Schedule of Overassessments numbered IT—99148 for the taxable year referred to, and that to the extent your claim was disallowed, notice would be issued.
>
> In accordance with the provisions of section 3772 (a) (2) of the Internal Revenue Code, this notice of disallowance of your claim or claims to the extent not previously allowed, is hereby given by registered mail.

The certificate of overassessment referred to in the second paragraph quoted above, had no reference to a claim for refund based on the inventory adjustment.

9. Under the retail method all items of merchandise sold in a store are broken down into types of classifications (such as women's coats, men's suits, women's shoes, lamps, floor covering, etc.). Each classification of merchandise is then given a department name and number and the department's inventory, stated in aggregate for all items of merchandise handled therein, is the smallest unit of inventory control in the store. At the close of the year, or more frequently, a store's inventory is taken by accumulating the results of the inventories of these separate departments. Kaufmann and Baer at all times material herein took inventory, in this manner, semiannually.

10. Under the retail method of inventorying, a record is kept for each department of the aggregate cost of all of the items in its inventory. This aggregate cost for a particular year includes both the aggregate cost of the opening inventory for that year and the aggregate cost of all items purchased for that department during that year. In addition to the cost record, a record is kept for each department of the aggregate retail prices of all the items in its inventory, again including both the opening inventory and pur-

chases made during the year. At the end of the year the aggregate opening cost inventory, plus purchases at cost, is subtracted from the aggregate opening retail inventory, plus purchases at retail, to determine the aggregate net markup achieved by the department during the year. This average net markup is then divided by the aggregate opening retail inventory, plus purchases at retail, with proper adjustment to selling prices for all markups and markdowns, in order to determine the mark-on percentage achieved by the department during the year. The percentage complementary to the mark-on percent is the cost rate incurred by that department. The retail value of the closing inventory is computed by adding the retail values of the various items of merchandise on hand in the department at the date the inventory is taken. This value must be converted to cost before being credited to the cost-of-goods-sold account. The conversion is made by multiplying the aggregate retail inventory by the cost rate incurred by the department during the year, that is, by the complement of the mark-on percent.

11. For all years up to and including the fiscal year ended January 31, 1941, Kaufmann and Baer employed the retail method of taking inventories on a first-in, first-out basis, commonly known as FIFO. In determining inventory at the end of the fiscal year, this method assumes that an article of merchandise "first-in," i. e., the article purchased earliest, was the first one sold, and that the articles left in the inventory at the end of the year were the last articles purchased. The cost of the items in the inventory at the end of the year would be based on the cost of the last articles purchased.

The LIFO method of inventory assumes that an article of merchandise "last-in," i. e., the article purchased last, was the first sold and that the articles left in the inventory

at the end of the year were the first articles purchased. The cost of the items in the inventory at the end of the year would be based on the cost of the first articles purchased.

The difference between FIFO and LIFO insofar as it relates to profits and taxable income is illustrated (a) in a period of rising prices and (b) in a period of falling prices as follows:

(a) During a period of rising prices, a retailer starts out with one shirt which cost him $2. He buys another for $3. He sells one for $4. His closing inventory and profits on a FIFO and LIFO basis will be as follows:

FIFO		LIFO	
Opening Inventory	$2.00	Opening Inventory	$2.00
Cost of Purchases	3.00	Cost of Purchases	3.00
Total	5.00	Total	5.00
Less Cost of Closing Inventory (last in)	3.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Sales	$4.00	Sales	$4.00
Cost of Goods Sold	2.00	Cost of Goods Sold	3.00
Gross Margin	2.00	Gross Margin	1.00

On the FIFO basis, $1 of the $2 gross margin represents paper profit since the retailer must keep a stock of one shirt. On the LIFO basis, there is no paper profit because LIFO asumes that a retailer's basic inventory (one shirt in this example) is carried on the books at a stabilized value.

(b) During a period of falling prices, the difference between FIFO and LIFO is illustrated by the following example: Assume that in the following year, the retailer buys

another shirt for $2 and sells one for $3 instead of $4. His inventory and profits on a FIFO and LIFO basis for such second year will be as follows:

FIFO		LIFO	
Opening Inventory	$3.00	Opening Inventory	$2.00
Cost of Purchases	2.00	Cost of Purchases	2.00
Total	5.00	Total	4.00
Less Cost of Closing Inventory (last in)	2.00	Less Cost of Closing Inventory (first in)	2.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Sales	$3.00	Sales	$3.00
Cost of Goods Sold	3.00	Cost of Goods Sold	2.00
Gross Margin	NONE	Gross Margin	1.00

12. In 1942 and 1943 and continuously thereafter until 1948, the Treasury Department and the Bureau of Internal Revenue took the position that LIFO was available only to taxpayers who applied the method to the cost of specific inventory items and that LIFO was not available to taxpayers who applied the method to the total inventory for a department store. For this reason such agencies held that LIFO was not available for use in computing the income of retail department stores which applied LIFO to the total inventory for each store department, such inventory being stated in terms of dollar values in accordance with the retail inventory method. The Treasury Department regulation, promulgated under section 22 (d) of the Internal Revenue Code, made no provision for retailers to use LIFO and made no provision for the employment of retail price index figures to apply LIFO in connection with the retail inventory method. On February 5, 1944, in pursuance of such position, the Bureau of Internal Revenue issued a deficiency notice to Hutzler Brothers Company, a Baltimore depart-

ment store. This notice disapproved the adoption and use by Hutzler Brothers Company of LIFO by employment of retail price index figures in connection with the retail inventory method for the taxable year of said Company ended January 31, 1942. Continuously thereafter the Treasury Department and the Bureau of Internal Revenue maintained the position that LIFO was not available for use by taxpayers who did not apply the method to determine the cost of specific items of inventory. In 1947 the Tax Court of the United States decided (8 T. C. 14) in favor of the adoption and use of LIFO by Hutzler Brothers by employment of retail price figures in connection with the retail inventory method for its taxable year ended January 31, 1942, and thereafter the Treasury Department and the Bureau of Internal Revenue agreed that LIFO was available for use in determining the income of retail department stores by application of the method of the total inventory for each department (stated in terms of dollar values determined by the retail inventory method).

13. Until October 21, 1942, the date of approval of the Revenue Act of 1942, section 22 (d) (2) (B) and Treasury Regulations 101, as amended by T. D. 4959 (1940-1 Cum. Bull. 22), approved December 28, 1939, limited the use of LIFO to taxpayers who could establish as a fact that they had not used any procedure other than LIFO in inventorying goods for any period during the first taxable year for which the LIFO method was to be used. Kaufmann and Baer Company was therefore ineligible to use LIFO until that date since it had prepared an interim statement for the period February 1, 1941, to July 31, 1941, which did not use LIFO, and this statement was included in a statement of the earnings of the consolidated Gimbel Companies, which was published in an interim report distributed to the stockholders of Gimbels and covering the same six-month period.

14. Section 118 of the Revenue Act of 1942 removed the prohibition against the adoption of LIFO for a year during which interim reports on a non-LIFO basis had been issued. This change was retroactive to taxable years beginning after December 31, 1938. It did require that annual reports be made on a LIFO basis. Gimbels' directors, at a special meeting on April 9, 1942, decided that it would be in the best interests of the company to adopt the LIFO method and they then approved a statement prepared for release to Gimbels' stockholders which included a letter addressed to the directors on April 9, 1942, by Touche, Niven and Company, accountants for Gimbels and its subsidiaries, including Kaufmann and Baer. This statement was an annual report of Gimbel Brothers, Inc., and subsidiary companies for the year ended January 31, 1942. It was dated for release and released to all stockholders of Gimbels on April 11, 1942. It read in part:

> Merchandise inventories at January 31, 1942 aggregated $17,809,565 compared with $13,130,458 a year ago, an increase of $4,679,107. Although the basis of "cost or market, whichever is lower" has been continued this year "cost" was determined pursuant to the "last-in first-out" (LIFO) method based upon an index of retail price changes since January 31, 1941. Under the "last-in first-out" method, unrealized price increases are excluded from income and inventories are carried forward at lower values. As a result of this change, inventories and profits before Federal taxes on income were $1,867,469 less than on the basis formerly used, and provision for these taxes was lower by $1,311,000, resulting in a net reduction of $556,469 in profits as above stated. While "last-in first-out" is an acceptable method of inventory valuation under present tax laws for certain types of business, amendments to the tax laws will be necessary for its use by us for the year covered by this report. If adequate retroactive legisla-

tion is not enacted, the taxable income will be increased by approximately $1,867,469 and the Federal tax liability will be increased by $1,311,000, the amounts above mentioned.

A similar statement and report to stockholders for the year ended January 31, 1943, also was approved by Gimbels' directors and released to its stockholders. It was dated for release and released on April 24, 1943, and it read in part:

> Merchandise inventories at January 31, 1943 aggregated $24,101,609 compared with $19,677,035 a year ago, an increase of $4,424,574. As was explained in the Annual Report for the year ended January 31, 1942, the "last-in first-out" (LIFO) method of determining inventory costs, based upon an index of retail price changes, was adopted for the year covered by the report. It was there pointed out that while such "last-in first-out" method might not be used for tax purposes under the then existing provisions of the tax laws, there was reason to believe that retroactive legislation might be enacted permitting such use. Legislation subsequently enacted was only part of that contemplated at the time the report was issued. It has been determined, therefore, to abandon the "last-in first-out" method of inventories and to return to the method formerly in use, and to adjust the figures for the year ended January 31, 1942 accordingly. This has resulted in an adjustment increasing the net profits for the year ended January 31, 1942 by $556,469. Of such increased net profits it has been deemed advisable to transfer $500,000 to a reserve for post-war contingencies. The balance has been added to earned surplus. The comparative figures for the year ended January 31, 1942 above set forth have been adjusted so as to present them as if the "last-in first-out" method of inventory had not been in use during that year.

15. The principal reason for the insistence of the Treasury Department and the Bureau of Internal Revenue that retailers were not entitled to use the LIFO method of inventorying authorized in section 22 (d) of the Internal Revenue Code lay in the manner by which inventories are valued under the retail method of inventorying (the method used by Kaufmann and Baer). The Treasury Department and Bureau of Internal Revenue constantly maintained that the nature of the retail method of inventorying made it impossible for retailers to elect LIFO since the Internal Revenue Code permitted the election of LIFO only as to "goods specified in the application," whereas under the retail method inventories are stated in terms of dollar values rather than in terms of specific goods, a procedure which, they asserted, lacked the specification required by the section.

Due to the multiplicity of items carried by retail department stores, and the varying price ranges of these items, it is not practicable to control the inventories of these stores on an item basis. The retail method of inventorying was developed early in the history of the industry and it has been long approved by Treasury Department regulations and was used at all times by Kaufmann and Baer.

16. The Revenue Act of 1942 was approved October 21, 1942, at 4:30 p. m., 56 Stat. 798. Treasury Regulations 103, applicable at that time, were amended to conform to sections 118 and 119 of the Revenue Act of 1942 in T. D. 5199, 1942–2 Cum. Bull. 81, approved December 10, 1942, and first published in the Federal Register on December 12, 1942, pp. 10366–10368. As amended by paragraph 2 T. D. 5199, section 19.22 (d)–3 of Treasury Regulations 103 read in part as follows:

> *Time and Manner of Making Election.*—The elective inventory method may be adopted and used only if the

> taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. * * *

Neither Gimbels nor Mr. Friedman, of Touche, Niven and Company, thought that this quoted language applied to retailers generally or to their own tax problem and they did not ask for any extension of time after March 10, 1943, within which to file Treasury Form 970.

17. Section 118 of the Revenue Act of 1942 removed the prohibition against the adoption of LIFO for a year during which interim reports on a non-LIFO basis had been issued and this amendment was made retroactive to all taxable years beginning after December 31, 1938. It retained the requirement that the annual reports be made on a LIFO basis, and Kaufmann and Baer's final report on its earnings for the year ended January 31, 1942, was prepared by an application of LIFO (as described in the annual report made by Gimbels to its stockholders as certified by Touche, Niven and Company) to the retail method of inventorying.

18. At the end of December 1942, there was a meeting of plaintiffs' executives at which Mr. Friedman, of Touche, Niven and Company, was present to consider the problem of using LIFO inventories with respect to the Federal income tax returns which had already been filed for the fiscal year ended January 31, 1942, for all the Gimbel companies including Kaufmann and Baer. It was decided at that meeting plaintiffs should file refund claims for the fiscal year ended January 31, 1942, and elections on Form 970 to adopt LIFO for the fiscal year ended January 31, 1942.

At the conference between plaintiffs' officials and Mr. Friedman held at the end of December 1942, Mr. Friedman was instructed to prepare the necessary claims and elections and whatever forms were appropriate to permit plaintiffs to adopt LIFO for the fiscal year ended January 31, 1942. Plaintiffs relied on Mr. Friedman for the timely preparation of such necessary forms.

19. Pursuant to such instructions, Touche, Niven and Company, accountants for Kaufmann and Baer and Gimbels, prepared the claims for refund and election document referred to in finding 6. These documents were delivered by messenger to plaintiffs on March 25, 1942. Thereafter, they were properly signed and filed as shown in finding 6. No one from Touche, Niven and Company advised plaintiffs that these documents had to be filed by any specific date.

The firm of Touche, Niven and Company believed that plaintiffs, having filed their returns and paid the tax for the fiscal year ended January 31, 1942, thereby being unable to attach the Form 970 to the return, that the proper procedure would be to file a claim for refund and attach the Form 970 to the claim. The firm also believed that the time limitations had no application to retailers because of the strong position the Bureau of Internal Revenue had taken against permitting such retailers to employ the LIFO method.

Form 970 was available around the end of February 1943. The computations necessary to establish the amount of the refunds were numerous and to have prepared them after the issuance of the Treasury Decision of December 10, 1942, and before March 10, would have cast a heavy burden on the staff of Touche, Niven and Company.

Touche, Niven and Company, now known as Touche, Niven, Bailey and Smart have been auditors for Gimbels and its associates since 1922.

20. During the fiscal year ended January 31, 1943, Gimbels issued an interim report to its stockholders and this, showing consolidated operations in which the inventories were computed on the LIFO basis, covers the period February 1, 1942, to July 31, 1942.

21. On April 20, 1943, a meeting of the board of directors of Gimbels was held to determine the basis for inventory to be used with respect to the fiscal year ended January 31, 1943. Mr. Friedman of Touche, Niven and Company, was present at that meeting and he told the board that the Treasury Department and the Bureau of Internal Revenue were adamant in their position that retailers could not elect to adopt LIFO; that there were disadvantages to keeping the books on a LIFO basis, and filing income tax returns on a FIFO basis since earnings would be completely distorted because LIFO would not only produce lower earnings but such earnings would be reduced by the accrual of income taxes computed on a FIFO basis; and that for these reasons many other department stores were reverting to FIFO. Thereupon, the board of directors of Gimbels determined to issue the report to stockholders for the year ended January 31, 1943, on a FIFO basis but with a deduction for reserves.

On April 24, 1943, Gimbels issued its annual report to stockholders for the fiscal year ended January 31, 1943, covering the operations of itself and its subsidiaries, including Kaufmann and Baer, stating its inventories on the basis of FIFO but setting up a reserve against profits, the effect of which was to show profits at about the same amount which would have been stated had the company continued on a LIFO basis.

22. As a result of its decision of April 20, 1943, with respect to the report to stockholders for the fiscal year ended

January 31, 1943, the board of directors of Gimbels decided that it would request permission to withdraw the elections to adopt LIFO for the fiscal year ended January 31, 1942, filed for itself and its subsidiaries including Kaufmann and Baer.

23. On April 28, 1943, Kaufmann and Baer addressed a letter to the collector at Pittsburgh, Pennsylvania, relating to the refund claim and to the application to adopt LIFO filed on March 31, 1943 saying: "This is to advise you that we desire to withdraw this claim for refund and our application for change in inventory method." The collector replied in a letter addressed to Kaufmann and Baer on April 30, 1943, stating that the claim for refund had been forwarded to the office of the Commissioner of Internal Revenue in Washington, D. C., and in part said: "This office suggests that you advise that office of your intention." On May 5, 1943, Kaufmann and Baer addressed a letter to the Commissioner of Internal Revenue in Washington, reading as follows:

> Under date of March 30, 1943, we filed with the Collector of Internal Revenue at Pittsburgh, Pennsylvania, a claim for refund for Kaufmann and Baer Company in the amount of $106,287.97 as a result of the change of inventory method, and at the same time made application for permission to change our inventory method to a LIFO basis.
>
> We attach hereto copy of the letter from the Collector of the 23rd District of Pennsylvania, stating that the claim was forwarded to the Office of the Commissioner under date of April 17, 1943.
>
> Accordingly, we wish to advise you that we desire to withdraw this claim for refund and also to withdraw, or cancel, our application for a change in our inventory method.

On May 27, 1943, a letter was addressed by a deputy commissioner to Kaufmann and Baer, reading as follows:

> Reference is made to your letter dated May 5, 1943, relative to your claim for refund of income tax in the amount of $106,287.97, for the fiscal year ended January 31, 1942.
>
> Your case is being forwarded to the Internal Revenue Agent in Charge, 2300 Farmers Bank Building, Pittsburgh, Pennsylvania, for investigation. You will be further advised by that official relative to the matter.

24. At the date the plaintiffs commenced this proceeding, all of the tax years subsequent to 1942 of Gimbels and its subsidiaries including Kaufmann and Baer were open by waiver or otherwise and the Commissioner of Internal Revenue, if the price spiral had turned in the other direction, could have assessed deficiencies for each of the years subsequent to 1942 if plaintiffs' LIFO elections were timely and irrevocable because no permission had ever been granted to Kaufmann and Baer to withdraw the election to adopt LIFO.

25. On May 27, 1948, Gimbels issued its annual report to stockholders for the fiscal year ended January 31, 1948. In said report, the inventories were stated on a LIFO basis for the fiscal year ended January 31, 1948, and restated on a LIFO basis for the fiscal years ended January 31, 1943, to January 31, 1947, inclusive. Its Federal income tax return for the fiscal year ended January 31, 1948, was also filed on a LIFO basis.

26. Subsequent to the decision of the Tax Court in the *Hutzler* case, the Treasury Department issued proposed regulations under which stores, like Hutzler Brothers Company and the other members of the group of the National Retail Dry Goods Association which cooperated with Hutz-

ler Brothers in the litigation before the Tax Court, were permitted to adopt the LIFO inventory method for the fiscal year ended January 31, 1942, and for subsequent years even though the elections filed by these companies for the fiscal year ended January 31, 1942, were invalid and they had filed no new elections. Thereupon, plaintiffs objected to the proposed regulations because they did not provide relief for plaintiffs who in good faith had attempted to adopt LIFO but had been dissuaded from such position by virtue of the Treasury's objection. Thereafter the Treasury advised plaintiffs that the regulations would be drawn to apply to those retailers who had persisted in the contest of this issue and the retailers in the category of the plaintiffs who had not so persisted would be covered by separate regulations. About a year later, plaintiffs were informed by the Treasury Department that the Department did not intend to draft regulations applicable to plaintiffs and other retailers who had evidenced an intention to and had taken affirmative steps to adopt LIFO and who were dissuaded from that position by the Treasury Department's announced policy that LIFO was not available to retailers.

27. On April 20, 1951, E. I. McLarney, Deputy Commissioner of Internal Revenue, wrote to the internal revenue agent in charge, 341 Ninth Avenue, New York 1, New York, with respect to plaintiff's claim in part as follows:

> The Chief Counsel has determined with reference to the taxpayers' suits pending in the United States Court of Claims that the single issue involved, i. e., whether the taxpayers are entitled to use the Lifo inventory method, is susceptible of administrative settlement and in this connection has requested that your office determine the proper amount of the Lifo inventories and the refunds of tax for all years for which claims have been filed.

28. In 1951 plaintiffs had requested an extension of time from the Commissioner of Internal Revenue with respect to the filing of elections to have the provisions of section 22 (d) (6) of the Internal Revenue Code and section 29.22 (d)–7 of Regulations 111 apply to certain involuntary liquidations of LIFO inventories sustained during the fiscal years ended January 31, 1942, to January 31, 1947, inclusive.

29. In the spring or summer of 1952, Revenue Agent Abramowitz appeared at the offices of the plaintiffs and advised Mr. Samuel Nass that the claims for refund which had been filed by Gimbels and its subsidiary companies, including Kaufmann and Baer, had been forwarded to him for examination and verification to determine the amount of the refunds to be made in the event of an administrative decision that the refund would be allowed.

30. On June 6, 1953, a meeting was held, attended by plaintiffs' executives and their attorney, Kenneth Gemmill of the Treasury Department, Mr. Davis, Chief Counsel of the Bureau, and about 15 other representatives of the bureau. At that meeting, the representatives of the bureau stated that they had come to the conclusion that plaintiffs' claims would not be allowed because the Form 970 elections had not been filed within the time required by T. D. 5199 and, furthermore, the elections had been withdrawn. This was the first time that these objections to the allowance had been raised with the plaintiffs by either the Treasury Department or the Bureau of Internal Revenue.

31. In the event that it is held that plaintiffs are entitled to a refund of taxes paid by the Kaufmann and Baer Company, judgment may be entered in favor of Gimbel Brothers, Inc., as the successor to the said Kaufmann and Baer Company.

32. It has been stipulated that in the event this court shall determine the issue involved in this proceeding in

favor of the plaintiffs, the amount to be refunded for the fiscal year ended January 31, 1942, exclusive of plaintiffs' claim under the involuntary conversion statute (section 22 (d)–6, Internal Revenue Code) is $63,199.43 in income tax and $8,572.27 in declared value excess profits tax less $36,-991.85 which represents the additional tax for the fiscal year ended January 31, 1941, because of the change in the amount of inventory at the beginning of the fiscal year ended January 31, 1942. Said refunds have been computed on the LIFO basis in accordance with the applicable Treasury Regulations.

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes that as a matter of law the plaintiffs are not entitled to recover, and the petition is therefore dismissed.

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 212

KAUFMANN AND BAER COMPANY

AND

GIMBEL BROTHERS, INC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. 27–36) is reported at 137 F. Supp. 725.

JURISDICTION

The judgment of the Court of Claims was entered on January 31, 1956. The petition for a writ of certiorari was filed on June 28, 1956, the time for filing having been extended to June 29, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. 1255 (1).

QUESTION PRESENTED

Whether the taxpayer made a valid election to adopt for the fiscal year ending January 31, 1942, the last-in, first-out method of valuing inventories (commonly known as LIFO) under Section 22 (d) (2) of the Internal Revenue Code of 1939, as amended, so as to entitle it to have its taxable income for that year computed on that basis.

STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved are sections 22 and 3772 of the Internal Revenue Code of 1939, Sections 19.22 (d)–1, 19.22 (d)–2, 19.22 (d)–3 and 19.22 (d)–5 of Treasury Regulations 103, and Mim. 6244, 1948–1 Cum. Bull. 21. All are set forth in the Appendix, *infra*, pp. 20–27.

STATEMENT

The pertinent facts, in the main set forth in the findings of fact of the Court of Claims (Pet. 36–55), are as follows:

Gimbel Brothers, Inc., herein referred to as Gimbels, is a New York corporation engaged in the business of operating department stores. It maintains its principal office and place of business in the City of New York. (Pet. 37.)

From March 15, 1926, until January 31, 1946, Kaufmann and Baer Company, a Pennsylvania corporation owning and operating a retail department store in Pittsburgh, Pennsylvania, was a wholly owned subsidiary of Gimbels. On the latter date, Kaufmann and Baer, herein referred to as taxpayer, was dissolved and all of its assets were transferred to its parent, Gimbels. (Pet. 36–38.)

Kaufmann and Baer kept its books and filed its federal tax returns on an accrual method of accounting

for fiscal years ending January 31. Because it is not practicable to control inventories of department stores on an item basis, the industry early developed the retail method of taking inventory, which has long been approved by Treasury regulations and was at all times used by Kaufmann and Baer in computing the cost of goods sold. (Pet. 38, 47.)

Under the retail method of inventorying, the total merchandise carried is broken down into classifications (such as women's coats, men's suits, appliances, etc.), each of which is given a department name and number. In computing the closing inventory, a dollar figure is arrived at for each department by cumulating the retail prices for all merchandise in the department as of the closing inventory date. This value is converted to cost by applying the mark-on per cent.[1] The resultant figure is the closing inventory for the department. The sum of the closing inventories for all departments represents the closing inventory for the store, which figure is credited to the cost-of-goods-sold account in arriving at gross profit. (Pet. 40–41.)

For all years up to and including the fiscal year ended January 31, 1941, Kaufmann and Baer employed the retail method of taking inventories on a first-in, first-out basis (commonly known as FIFO), as

[1] The mark-on per cent represents the average net markup for the department converted to a percentage of average retail sales. The average net markup is computed for each department by adding purchases at cost to the opening inventory at cost, and subtracting this figure from the total of opening inventory at retail plus purchases at retail. The result, when divided by the opening inventory at retail plus purchases at retail (with proper adjustments for all markups and markdowns), yields the mark-on per cent. (Pet. 40–41.)

opposed to last-in, first-out (LIFO).[2] During periods of rising prices, the use of LIFO will reflect smaller profits than will the use of FIFO.[3] (Pet. 41–43.)

Section 22 (d) of the Internal Revenue Code of 1939 made the elective method of inventorying goods (LIFO) available generally to all taxpayers who could meet the requirements therein established. These requirements were in part that the inventory must be valued at cost, and that no method other than LIFO shall have been used for any period beginning with or during the first taxable year for which LIFO was to be used. Under the section as it read prior to its amendment on October 21, 1942, LIFO could not be adopted beginning with a taxable year during any part of which another inventory method had been used for purposes of interim or annual reports to shareholders or creditors. Kaufmann and Baer had prepared an interim statement for the period February 1, 1941, to July 31, 1941, which did not reflect the use of LIFO, and which was included in a consolidated statement of Gimbels presented in an

[2] The FIFO method assumes that the first goods purchased were the first ones sold, so that the ending inventory is made up of the last merchandise purchased. Under LIFO it is assumed that the last goods purchased were the first sold. (Pet. 41–42.)

[3] During periods of price fluctuations the gross profit tends not to be stable under FIFO because, for example, during a rising price period the ending inventory will be inflated (reflecting as it does the high prices of the latest goods purchased), thus reducing cost-of-goods-sold, and increasing gross profit. During a price decline the ending inventory will be reduced, which will reduce the gross profit. Under LIFO, however, the gross profit is stabilized somewhat because the ending inventory is presumed to be composed of merchandise purchased before the price inflation or deflation, as the case may be. (Pet. 41–43.)

interim report to Gimbels' stockholders. Therefore, under Section 22 (d) as it then read, Kaufmann and Baer was ineligible to use LIFO for the fiscal year ended January 31, 1942. (Pet. 44.)

From 1942 until 1948, the Internal Revenue Bureau maintained the position that LIFO was available only if applied to the actual cost of specific items of merchandise. Section 22 (d) (2) (A) permitted LIFO only as to "goods * * * specified in an application to use such method". Therefore, the Internal Revenue Bureau reasoned that it was not available to taxpayers using the retail inventory method because such inventory represented the estimated cost of groupings of goods stated in terms of dollar values rather than an itemized list of the cost of each article. (Pet. 43, 47.) Accordingly, the regulations made no provision for the use of ~~such~~ price indices reflecting relative changes in market prices. (Pet. 43.) Such indices would be required to apply LIFO to the retail inventory method.

Section 118 of the Revenue Act of 1942, effective October 21, 1942, amended Section 22 (d) of the Internal Revenue Code so as to remove the prohibition against the use of LIFO during a year in which interim reports showed that a non-LIFO method had been used. The amendment was retroactive to taxable years beginning after December 31, 1938. (Pet 44, 45.)

Touche, Niven and Company were the accountants for Gimbels and its subsidiaries, including Kaufmann and Baer. Mr. Friedman of Touche, Niven antici-

pated that Section 22 (d) would be amended so as to remove the interim report obstacle. In accordance with his recommendation, Gimbels' directors decided to adopt LIFO for the fiscal year ended January 31, 1942, and so informed the stockholders in the annual report for that year dated April 11, 1942. (Pet. 45; R. 122–123.) The federal tax returns were due on April 15, 1942, but an extension was obtained in the hope that the amendment removing the interim report obstacle would be passed quickly. It was decided to file the returns by July 15 on the FIFO basis and, if the law was amended, to file either amended returns or claims for refund. The returns were filed on July 13, 1942, on a non-LIFO basis, and all returns thereafter until 1948 were filed on a non-LIFO basis. (Pet. 38; R. 123–124.)

Section 22 (d) of the 1939 Code, as amended by Section 118 of the Revenue Act of 1942, which eliminated the interim report obstacle, provided that the change to the LIFO method should be in accordance with regulations to be promulgated by the Commissioner. Accordingly, Section 19.22 (d)–3, Treasury Regulations 103, was amended by T. D. 5199, 1942–2 Cum. Bull. 81, approved December 10, 1942, so as to read in part as follows:

> *Time and manner of making election.*—The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision

> 5199, then at any time prior to such date) in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. * * *

T. D. 5199 was first published in the Federal Register on December 12, 1942. (Pet. 47–48.)

At a meeting of the executives of Gimbels and the taxpayer in December, 1942, at which meeting Mr. Friedman was present, it was decided to file elections on Form 970 to adopt LIFO for the fiscal year ended January 31, 1942, and, based on such election, to file claims for refund for that year. Mr. Friedman was instructed to prepare the necessary elections and claims for refund. Because the attitude of the Internal Revenue Bureau had been against permitting retailers to employ LIFO, Mr. Friedman did not think the time limit in T. D. 5199 applied to the taxpayer and did not request an extension of time to file Form 970 after March 10, 1943. (Pet. 48, 49.) Mr. Friedman knew that it was accepted practice to ask for extensions of time to file returns, if needed, and that such requests for extensions were ordinarily granted. (R. 148.) For example, the original returns for the fiscal year ended January 31, 1942, were filed late as the result of obtaining such an extension. (R. 123–124.)

Touche, Niven and Company prepared the claims for refund and the elections on Form 970 (Rev.), which differed very little from the old Form 970. These documents were delivered to the taxpayer on

March 25, 1943, executed March 29, 1943, and filed with the Collector of Internal Revenue at Pittsburgh on March 31, 1943. Form 970 (Rev.) was available at the end of February, 1943. (Pet. 38–39, 49; R. 140–141.)

Based on Mr. Friedman's advice that the Bureau of Internal Revenue was adamant in its position against permitting retailers to use LIFO, and that it was burdensome to keep books on LIFO while filing returns on FIFO, it was decided at a meeting of the board of directors of Gimbels on April 20, 1943, to return to FIFO. An annual report covering the operations of Gimbels and its subsidiaries, including taxpayer, for the year ended January 31, 1943, was issued the stockholders on April 24, 1943, stating inventories on the basis of FIFO. (Pet. 50.)

Thereafter, taxpayer notified the Collector at Pittsburgh on April 28, 1943, and the Commissioner of Internal Revenue at Washington on May 5, 1943, that it desired to withdraw its claim for refund for $106,287.97 and its application for change in inventory method filed on March 31, 1943. (Pet. 51.) However, on August 16, 1945, taxpayer was notified by the Deputy Commissioner that the claim for refund was rejected.[4] (Pet. 39–40.) This action was commenced in the Court of Claims on August 11, 1947, within two years after August 16, 1945. (Pet. 32.)

Some 30 to 40 stores which were members of the National Retail Dry Goods Association attached to

[4] This letter also made reference to a Certificate of Overassessment in the amount of $31,486.16 allowed taxpayer for the year ended January 31, 1942, but this matter is entirely unrelated to the question of inventory adjustments. (Pet. 39–40.)

their tax returns for the year ended January 31, 1942, their elections on Form 970 to use LIFO. This was prior to the amendment of October 21, 1942. In this group were Hutzler Brothers, Federated Department Stores, Allied Department Stores, and Halle Brothers. Gimbels was a member of the Association, but did not join this group in contesting the position of the Internal Revenue Bureau. (R. 78–80.) Touche, Niven handled the accounts of Federated Department Stores and Allied Department Stores. (R. 119.) Members of the group cooperated with Hutzler Brothers, to whom a deficiency notice had been issued by the Bureau based on the disallowance of the LIFO method, in presenting a test case before the Tax Court. On January 14, 1947, the Tax Court decided in favor of adoption and use of LIFO by retail department stores. *Hutzler Brothers* v. *Commissioner,* 8 T. C. 14. The Treasury proposed drawing regulations to give relief to those retailers who had filed their elections before October 21, 1942, and who had persisted in contesting the matter, even though no new elections had ever been filed by them on Form 970 (Rev.) after October 21, 1942 (Pet. 43–44, 52–53.)

Taxpayer and Gimbels were not included in this group. Negotiations looking toward ultimate allowance of LIFO for the taxpayer were conducted, but were unsuccessful. The Internal Revenue Bureau would not allow the claim because the Form 970 election had not been filed within the time required by T. D. 5199, and because the election had been withdrawn. (Pet. 53–54.) The Court of Claims dismissed the petition on the ground that the taxpayer did not

file a timely election to change to LIFO. (Pet. 33, 36.)

ARGUMENT

The special facts of this case present a narrow issue which does not merit review by this Court. The decision of the Court of Claims is clearly correct. Contrary to the assertion of the taxpayer (Pet. 10),[5] the case does not involve any questions of general importance which should be settled by this Court. Moreover, there is no conflict with any Court of Appeals decision.

1. The taxpayer, in effect, concedes that its attempted election to adopt the last-in, first-out method of taking inventory (LIFO) for the fiscal year ended January 31, 1942, was untimely by the terms of T. D. 5199, 1942–2 Cum. Bull. 81,[6] which amended Treasury Regulations 103, Section 19.22 (d)–3.[7] But it contends (Pet. 10–12) that T. D. 5199 was meant to apply only to those taxpayers who were entitled under the regulations to use LIFO; that inasmuch as the Treasury Department would not recognize that LIFO was available to department store retailers under the regulations, T. D. 5199 did not apply to it; and that it was not, therefore, bound by the 90-day limitation.

This reasoning ignores, however, the central fact that the taxpayer was legally entitled to use LIFO under the regulations. While it may be that the In-

[5] Any reference to taxpayer's contention includes petitioner Gimbels, taxpayer's parent and transferee.

[6] See *supra*, pp. 6–7.

[7] The regulations as amended by T. D. 5199 are set forth in the Appendix, *infra*, pp. 23–26.

ternal Revenue Bureau construed the regulations for a time as denying LIFO to retailers, the Bureau's interpretation was rejected in *Hutzler Brothers Co.* v. *Commissioner,* 8 T. C. 14. It was there successfully urged that the existing regulations, augmenting Section 22 (d) of the 1939 Code,[8] did not exclude department store retailers from adopting LIFO. Upholding this contention, the Tax Court did not invalidate the regulations.

The taxpayer can derive no support for its position from the action of the Commissioner, after acquiescing in the *Hutzler Brothers* decision, in issuing Mim. 6244, 1948–1 Cum. Bull. 21[9] to notify district collectors and other field agents that the regulations were being amended to expressly permit retailers to use LIFO. Under the Tax Court decision, this right was available to retailers in 1942 under the then existing regulations. Mim. 6244, and T. D. 5605, 1948–1 Cum. Bull. 16, therein referred to, were issued only to clarify the effect of the *Hutzler Brothers* ruling. Nor is it significant that the old regulations provided no price indices by which retailers could convert year-end prices back to the prices prevailing at the beginning of the year. That does not indicate that retailers were thereby excluded from using LIFO. Mim. 6244 points out that, even as amended, the regulations allow retailers to prepare their own indices.

Since LIFO was available to retailers under the regulations in force in 1942 (*Hutzler Brothers* v. *Commissioner, supra*), the 90-day time limitation con-

[8] See Appendix, *infra*, pp. 23–26.

[9] See Appendix, *infra*, pp. 26–27.

tained in these regulations was, as the court below pointed out (Pet. 33–34), fully applicable to the taxpayer. Accordingly, the Court of Claims correctly held that the taxpayer's election to adopt the LIFO method was ineffective because it was not timely filed. (Pet. 36.)

2. The taxpayer contends (Pet. 16–17) that, even if the 90-day period was applicable, it was an unreasonable time within which to require it to file an election. It bases this claim on the fact that Form 970 (Rev.) was not available until the end of February, leaving little more than 10 days to file a complex form.[10]

According to the taxpayer's own theory of the case, however, it paid little heed to the time limitation because of its opinion that the limitation had no application to retailers. There is no basis for assuming that the late filing can be attributed to the lack of adequate time. (Pet. 48, 49.) In this respect, the Court of Claims found that (Pet. 35):

> Had plaintiff been aware of its rights and acted with diligence it could easily have filed its election within the 90-day period.

The Government is not to blame if the taxpayer misconstrued and thereby sat too long on its rights.

Furthermore, the taxpayer was well aware that it was accepted practice to request—and obtain, without difficulty—extensions of time to file returns. (R. 148;

[10] It should be noted that Form 970 (Rev.) differed little, if at all, from the old Form 970 already in use and available. (R. 140–141.) It was the old Form 970 on which Hutzler Brothers filed their election.

Pet. 38.) If it really felt that the 90 days was insufficient, it should have requested such an extension.

No reason appears, therefore, why vague standards of reasonableness should be substituted for the specific time limit established by the Commissioner. As the court below pointed out (Pet. 34), the time limit was clearly authorized by the statute (Section 22 (d) (3) of the 1939 Code), and "when the statute and valid regulations give a taxpayer a right it must protect and prosecute that right within the required period, or such extension thereof as may be secured, or the right is lost. Time limitations within which to make elections would be meaningless if the law were otherwise."

3. It is asserted (Pet. 13–14) that the Commissioner, by not waiving the statute of limitations for the taxpayer while allegedly waiving technical defects in the elections of other retailers, has so arbitrarily discriminated in the administration of the tax laws that his action is "inimical to the concept of equal protection of the laws" (Pet. 14).[11] Apparently this is a constitutional attack.[12]

As has been frequently noted, the Fifth Amendment contains no "equal protection" clause. See

[11] The taxpayer claims (Pet. 13) that the elections filed by the retailers who cooperated in the Hutzler Brothers litigation were invalid because those retailers had issued interim reports on a non-LIFO basis whereas, at the time of their filing, the statute provided that LIFO could not be adopted in a year during which an interim report on a non-LIFO basis had been issued.

[12] There is no claim that the Commissioner acted in derogation of his delegated powers or has exceeded his statutory authority.

Bolling v. *Sharpe*, 347 U. S. 497, 499. Hence, any charge of unconstitutionality based upon allegedly discriminatory federal tax treatment must be grounded on the Fifth Amendment "due process" clause. *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 584; *Sunshine Coal Co.* v. *Adkins*, 310 U. S. 381, 401. It has been stated that the Federal Government is "subject to restraints less narrow and confining" than are the States under the Fourteenth Amendment "equal protection" clause. *Steward Machine Co.* v. *Davis*, *supra*, p. 584; *Bromley* v. *McCaughn*, 280 U. S. 124, 139. Admittedly, however, discrimination in the application of the tax laws might be so arbitrary and unjustifiable as to violate due process. See *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 24–25; *Foley Securities Corp.* v. *Commissioner*, 106 F. 2d 731, 736 (C. A. 8th). But it is clear that there has been no invidious discrimination here.

The group of retailers aligned with Hutzler Brothers, apparently anticipating that the interim report obstacle would be removed by legislation, filed elections on Form 970 when they filed their returns. Their right to elect for the year ended January 31, 1942, was authorized retroactively by legislation on October 21, 1942. The Commissioner issued T. D. 5199 requiring elections to be made by March 10, 1943, on Form 970 (Rev.), which was almost identical to the old Form 970. To have required the Hutzler group to file new elections would have exalted form over substance without any corresponding benefit. See *United States* v. *Kales*, 314 U. S. 186; *United States*

v. *Memphis Cotton Oil Co.*, 288 U. S. 62; *Cumberland Portland Cement Co.* v. *United States*, 104 F. Supp. 1010 (C. Cls.). The October amendment in effect served to reach back and validate the elections, which in all respects were already valid except for the obstacle removed by the amendment. The Commissioner did not waive any technical defects. He was on timely notice by those entitled to adopt LIFO of their elections to do so.

The taxpayer, having filed its election late, is obviously not in a position to complain of discriminatory treatment. Its situation is completely unrelated to that of the Hutzler group. In short, there was no unreasonable classification of the type condemned by the Fifth Amendment.

4. The taxpayer claims (Pet. 15–16) that the Commissioner should be equitably estopped from interposing the 90-day period of limitations.

There are several elements usually regarded as essential to equitable estoppel. There must be a misrepresentation or concealment of material facts, known to the party estopped, but unknown to the other party, who must act to his detriment in reliance upon the misrepresentation. See Pomeroy, *Equity Jurisprudence*, Section 805 (4th ed.). But the misrepresentation must originate as a statement of fact rather than one of law or opinion. *Van Antwerp* v. *United States*, 92 F. 2d 871, 875 (C. A. 9th); *United States* v. *S. F. Scott & Sons*, 69 F. 2d 728, 732 (C. A. 1st). See *Robinson* v. *Commissioner*, 100 F. 2d 847, 849 (C. A. 6th), certiorari denied, 308 U. S. 567.

The alleged misrepresentation on which the taxpayer relies was an opinion of law. Therefore, estoppel is not applicable here, for "neither the taxpayer nor the Commissioner is estopped by the previous taking of an erroneous legal position." *Commissioner* v. *American Light & T. Co.*, 125 F. 2d 365, 366 (C. A. 7th). The taxpayer cannot shift the responsibility to the Commissioner merely because he advocated an erroneous view of the law. It was well aware that the Commissioner's interpretation was being contested by the Hutzler group. Its tax advisers, Touche, Niven and Company, were the accountants for at least two of the large retailers in that group. (R. 119.)

The taxpayer suggests (Pet. 15–16) that the Commissioner could have held it to its election if prices had gone down instead of up. This is not so, and the cases cited in support are not in point. The election, having been filed late, was invalid for all purposes and revocable.[13] Nor did the Commissioner even attempt to maintain a position of being able to jump either way, as taxpayer suggests. Its claim, based upon adoption of LIFO, was rejected in 1945.

It is the taxpayer, not the Commissioner (Pet. 16), which has attempted to indulge itself in the benefits which by hindsight now appear attractive. By 1948

[13] The contention was made by the Government, but not passed upon by the Court of Claims, that there was no jurisdiction in that court, or any court, to consider the suit for refund. The claim for refund, filed on March 31, 1953, was withdrawn by the taxpayer, along with the revocable invalid election, before six months had elapsed and without the Commissioner having acted on it. See Section 3772 of the Internal Revenue Code of 1939 (Appendix, infra, pp. 22–23).

it became perfectly apparent that it would have been of great benefit tax-wise to have been on LIFO for the preceding six years. But taxpayer and Gimbels had filed on FIFO all those years. If, however, they could convince the courts that an untimely election to use LIFO for the year ended January 31, 1942, later withdrawn, was valid, there might be a chance to recoup the loss. A better illustration of hindsight would be difficult to find.

5. There is no conflict with any Court of Appeals decision.

Contrary to the taxpayer's contention (Pet. 17–18), *Pictorial Review Co.* v. *Helvering,* 68 F. 2d 766 (C. A. D. C.), is in accord with the decision below. The statute involved in *Pictorial Review* allowed corporations which were affiliated within the meaning of the section to file either separate or consolidated returns; an election once made was irrevocable. The interpretative regulations, which the court held were valid while in effect, forbade the taxpayer from including the Excella Corporation in a consolidated return for 1924 as an affiliate. The regulations were later voluntarily revised by the Commissioner so that Excella qualified as an affiliate. It was held that, since the taxpayer had enjoyed no real right of election as to Excella before the revision of the regulations, it could now elect to file an amended consolidated return for 1924 with Excella included. Here, on the other hand, the regulations after October 21, 1942, never denied the taxpayer the free choice to elect LIFO. *Hutzler Brothers* v. *Commissioner,* 8 T. C. 14. It just did not avail itself of the

opportunity to elect within the valid time limitation established. Compare *Radiant Glass Co.* v. *Burnet,* 54 F. 2d 718 (C. A. D. C.).

There is likewise no conflict with *Stockstrom* v. *Commissioner,* 190 F. 2d 283 (C. A. D. C.), also cited by the taxpayer. (Pet. 18.) In that case, the Commissioner in 1948 had attempted to assess a gift tax deficiency for 1938 against a taxpayer who had omitted filing a return for 1938. To avoid the normal three-year statute of limitations, the Commissioner relied upon an exception in the statute to the effect that the limitations period was inapplicable where no return is filed by the taxpayer. The taxpayer's failure to file a return for 1938, however, was due to a revenue official's statement years before that no return need be filed. The court held that the Commissioner could not avail itself of the statutory exception where the taxpayer's failure to file a return is attributable to the action of the Commissioner or his representative. The difference between *Stockstrom* and the instant case is apparent. In *Stockstrom,* it was the Commissioner who sought to avoid the effect of a time limitation by relying on an omission he himself had caused. Here, it is the taxpayer who seeks to avoid the effect of a time limitation by relying on a general ruling of the Commissioner. Clearly the *Stockstrom* case does not lay down any broad principle that the Commissioner is bound by any erroneous position he should take on a legal issue. See *Goldfield Consol. Mines* v. *Scott,* 247 U. S. 126; *Automobile Club of Mich.* v. *Commissioner,* 230 F. 2d 585, 589 (C. A. 6th). Moreover, an alternative ground was relied upon in

the *Stockstrom* case. The Commissioner had obtained the facts and figures concerning the 1938 gifts from the taxpayer's books in 1941. Under Section 3612 of the 1939 Code, it was the Collector's duty to make a return from his own knowledge for the taxpayer. The court held that this duty should have been performed promptly, and could not be delayed so as to toll the statute of limitations.

CONCLUSION

The decision below is correct. There is no conflict in decisions, and no other reason appears which would call for review. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

OSCAR H. DAVIS,
Acting Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
ROBERT N. ANDERSON,
WALTER R. GELLES,
Attorneys.

JULY, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * *

(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) (1) [As amended by Sec. 219 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use

such method filed at such time and in such manner as the Commisisoner may prescribe; and

(B) [As amended by Sec. 118 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

(5) If taxpayer, having complied with paragraph (2), uses the method described in paragraph (1) for any taxable year, then such method shall be used in all subsequent taxable years unless—

(A) With the approval of the Commissioner a change to a different method is authorized; or

(B) [As amended by Sec. 118 (b) of the Revenue Act of 1942, *supra*] The Commissioner determines that the taxpayer has used for any such subsequent taxable year some procedure other than that spec-

ified in subparagraph (B) of paragraph (1) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or beneficiaries, or (ii) for credit purposes; and requires a change to a method different from that prescribed in paragraph (1) beginning with such subsequent taxable year or any taxable year thereafter.

In either of the above cases, the change to, and the use of, the different method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 3772. SUITS FOR REFUND.

(a) *Limitations.*—

(1) *Claim.*—No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

(2) *Time.*—No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of two years from the date of mailing by registered mail by the Commissioner to the taxpayer of a notice of the disallowance of the part of the claim to

which such suit or proceeding relates.
(26 U. S. C. 1952 ed., Sec. 3772.)

* * * * *

Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939:

SEC. 19.22 (d)–1 [as amended by T. D. 5605, 1948–1 Cum. Bull. 16]. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22 (c), and pursuant to the provisions of sections 19.22 (c)–1 to 19.22 (c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in acordance with the method provided by section 22 (d). * * *

* * * * *

If a taxpayer using the retail method of pricing inventories, authorized by section 19.22 (c)–8, elects to use in connection therewith the elective inventory method authorized by section 22 (d) of the Code, the apparent cost of the goods on hand at the end of the year, determined pursuant to section 19.22 (c)–8, shall be adjusted to the extent of price changes therein taking place subsequent to the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indices established to the satisfaction of the Commissioner. Price indices prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indices which are based upon inadequate records, or which are not subject to complete and detailed audit within the Bureau, will not be approved.

SEC. 19.22 (d)–2 [As amended by T. D. 5163, 1942–2 Cum. Bull. 80. and T. D. 5605, *supra*].

Requirements incident to adoption and use of elective method.—Except as otherwise provided in section 19.22 (d)–1 with respect to retail inventory computations, the adoption and use of the elective inventory method is, by section 22 (d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year with the exception that restoration shall be made with respect to any write-down to market values resulting from the pricing of former inventories;

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total

number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer; * * *

* * * * *

SEC. 19.22 (d)-3 [As amended by T. D. 5199, 1942-2 Cum. Bull. 81] *Time and manner of making election.*—The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised) and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. * * *

* * * * *

SEC. 19.22 (d)-5. *Revocation of election.*—An election made to adopt and use the elective inventory method is irrevocable, and the method once adopted shall be used in all subsequent taxable years, unless the use of another method

be required by the Commissioner, or authorized by him pursuant to a written application therefor filed with him as provided in section 19.41–2.

Mim. 6244, 1948–1 Cum. Bull. 21:

TREASURY DEPARTMENT

OFFICE OF COMMISSIONER OF INTERNAL REVENUE

Washington 25, D. C., March 9, 1948

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Field Divisions of the Technical Staff, and Others Concerned:

* * * * *

3. Treasury Decision 5605, approved March 4, 1948 [page 16, this Bulletin], amends Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers using the retail inventory method. Certain principles are laid down for the application of the elective inventory by such taxpayers. First, since the elective method requires the use of cost, the retail selling prices of goods included in the opening inventory and purchased during the year must be adjusted for mark-downs as well as mark-ups during the year without regard to the taxpayer's previous practice with respect to mark-downs under the retail method. This requirement does not apply to retailers employing the retail inventory method without the use of the elective method. Second, the price indices employed in the adjustment of the apparent cost of goods in the closing inventory for price changes taking place during the year must be shown, to the satisfaction of the Commissioner, to be acceptable. Any price indices must be based upon sound statistical principles of construction and upon adequate records to be kept available for examination by the Bureau.

4. Arrangements have been made between representatives of the retail trade and the United States Bureau of Labor Statistics for that agency to compute and publish a series of group index numbers of retail prices, on a country-wide basis, suitable for use by individual department stores, which will be acceptable to the Commissioner. These index numbers will cover the period from 1941 to the present on a semiannual basis, and will appear semiannually in the future. The use of such indices of the Bureau of Labor Statistics is not mandatory; indices may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indices, not only for the particular year in question, but for subsequent years. Retailers who have filed, on the basis of the elective method, returns for past years which are still open, and who used indices that are not acceptable to the Commissioner, may file amended returns employing indices.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 212

KAUFMANN AND BAER COMPANY

and

GIMBEL BROTHERS, INC.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITIONER'S REPLY BRIEF

HARRY J. RUDICK
Counsel for Petitioners
25 Broadway
New York 4, New York

ALEXANDER B. ROYCE,
MASON G. KASSEL,
ROBERT E. FRIOU,
Of Counsel.

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PETITIONER'S REPLY BRIEF

The arguments made by the respondent in its brief in opposition to the petition for a writ of certiorari to the United States Court of Claims do not squarely meet the points made by the petitioner, and, in addition, contain certain misstatements which should be called to the attention of the Court.

1. At no point does the respondent, nor indeed in fairness could it, dispute the contention that if the LIFO regulations did not apply to the petitioner, the

90-day limitations contained therein could not be applicable to the petitioner. The respondent's sole defense to this argument is that the regulations promulgated in 1942 were applicable to users of the retail inventory method. It is clear from the record, however, that the 1942 regulations were not applicable to such retailers. Indeed, the respondent concedes that the Internal Revenue Bureau itself at the time the regulations were promulgated in 1942, and during the entire 90-day period for filing the election, adamantly took the position that the regulations did not apply to these retailers. (Resp. Br. pp. 10-11). He further concedes that the regulations made no provision for the use of price indices reflecting relative changes in market prices, and that such changes would be required to apply LIFO to the retail inventory method. (Resp. Br. p. 5). The respondent's sole basis for its incorrect statement that the 1942 regulations were applicable to the petitioner is its contention that the Tax Court, in *Hutzler Bros. Company*, 8 T. C. 14 (1947) held that the regulations when promulgated in 1942, were applicable to retailers.

It is, however, perfectly clear from the decision in *Hutzler Bros., supra,* that the court at no point held that the 1942 regulations were applicable to users of the retail inventory method. In holding that such retailers were entitled to use LIFO, the court merely looked to the statute and its legislative history. Moreover, in stating that "the adoption of appropriate details to accomplish the general purpose of applying the LIFO method to retail merchants could well be the subject of an administrative regulation [but that] . . . no such regulation has been issued"*, the court recog-

*8 T. C. 14 at p. 32.

nized that the original LIFO regulations, when promulgated in 1942, were not applicable to users of the retail inventory method.

It is therefore apparent that the regulations were not applicable to users of the retail inventory method under the provisions in force in 1942, and consequently, the 90-day limitation contained therein could not apply to the petitioner.

2. The respondent's principal answer to the petitioner's contention that if the 90-day limitation were applicable to it, the Commissioner could not nullify such time period by requiring the election to be made on forms calling for complex calculations which were issued only shortly prior to the expiration of the 90 days, is that the petitioner could have asked for an extension of time to file its election. However, in making this allegation, the respondent completely overlooks the fact that in 1943 the regulations did not provide any authority for an extension of time with respect to an election and it was only in 1944, after the expiration of the 90-day period, that the regulations were subsequently amended to give such authority. See T. D. 5391, 1944 Cum. Bull., p. 474.

3. With respect to the petitioner's contention that the Commissioner could not, within the statutory powers delegated to him, arbitrarily discriminate in the administration of the tax laws by waiving technical defects in the LIFO elections filed by a large number of petitioner's competitors while at the same time refusing to waive a technical defect, if indeed there was one, in the election filed by the petitioner, the respondent concedes that a group of retailers filed invalid elec-

tions, and that the Commissioner waived this defect. (Resp. Br. pp. 14-15). The only justification given by the respondent for this arbitrary classification is that the invalid elections filed by the petitioner's competitors prior to the time the statute first entitled them to elect LIFO gave the Commissioner adequate notice that they were going to use LIFO. But the election filed by the petitioner within a reasonable period from the time the statute first gave it the right to elect LIFO, also gave the Commissioner adequate notice of the petitioner's election to use LIFO. Since the Commissioner was given adequate notice in both cases, there is no reasonable basis, by the respondent's own standards, to justify the discrimination, and clearly there was an arbitrary, unreasonable and discriminatory classification.*

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* Since the filing of the petition for a writ of certiorari, in the instant case, the Court of Claims has decided a case which completely supports the petitioner's contention that the Commissioner may not arbitrarily discriminate between two classes of taxpayers merely on the ground that one group of taxpayers paid its tax and the other group did not. In *Connecticut Railway and Lighting Company* v. *U. S.*, ... F. Supp. ..., 4 P-H 1956 Fed. Tax. Serv. Par. 72,829 (Ct. of Cl. 1956), the taxpayer lessor had included in income both the tax on the rentals for which it was reimbursed by the lessee and the tax paid as a result of including the initial tax in the lessor's income, for which it was also reimbursed. The Commissioner in administering the law, however, had taken the position that only the direct tax on the rentals, but not the tax on the tax, was includible in rental income, and the taxpayer filed a claim for refund for the tax paid on the tax. Subsequently, the Commissioner changed his position and ruled, prospectively only, that all Federal taxes paid by a tenant on behalf of the landlord, including the tax on the tax, must be includible in the lessor's income. But, despite the fact that this ruling was not retroactive, it provided that any income taxes which had already been paid on account of the inclusion in gross income of the taxes paid by the lessee would not be refunded. The taxpayer's objection that this ruling discriminated without justification between taxpayers who had paid their taxes and those who had not, was upheld by the Court of Claims, which allowed the refund.

4. In answer to the petitioner's contention that the Commissioner was estopped from asserting that the election filed by the petitioner was invalid because the Commissioner kept himself in a position where, with the use of hindsight, he could have moved either way and could have held petitioner to its election if the price spiral had gone down, the respondent states that the Commissioner could not have held the petitioner to its election because the election was revocable and was withdrawn. It is clear, however, that the petitioner's election was irrevocable by statute and that it could not have been withdrawn without the consent of the Commissioner, which consent was never given.* It should be noted in this connection that the court below did not pass on the question as to whether the petitioner's election had been withdrawn.

5. In answer to the petitioner's contention that the decision below conflicts with *Pictorial Review Co.* v. *Helvering*, 68 F. (2d) 766 (D. C. Cir. 1934), the respondent states that there is no conflict because, in the *Pictorial* decision, the regulations in question did not apply to the taxpayer, whereas, here, the LIFO regulations promulgated in 1942 did apply to and did give the petitioner a right of election. But, as noted previously, this statement is patently incorrect and the respondent's reliance on the decision in *Hutzler Bros. Company, supra*, to support its statement that the 1942 regulations applied to retailers is wholly unfounded.

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* See *Champlin* v. *Commissioner*, 78 F. (2d) 905 (10th Cir. 1935); *Pacific National Company* v. *Welch*, 304 U. S. 191 (1938); *Lucas* v. *St. Louis National Baseball Club*, 42 F. (2d) 984 (8th Cir. 1930); *Frank W. Keeler* v. *Commissioner*, 180 F. (2d) 707 (10th Cir. 1950).

Having failed to adequately answer the contentions made by the petitioner in the petition for a writ of certiorari to the United States Court of Claims, the respondent's brief in no way detracts from the reasons set forth in said petition why this Court should grant a writ of certiorari to the United States Court of Claims.

Respectfully submitted,

HARRY J. RUDICK
Counsel for Petitioners

Of Counsel
ALEXANDER B. ROYCE,
MASON G. KASSEL,
ROBERT E. FRIOU.